

**THE EFFECTIVE INTERNAL AUDIT FUNCTION AS PART OF A SOUND
CORPORATE GOVERNANCE STRUCTURE: THE CASE STUDY OF SALDANHA
BAY MUNICIPALITY**

By

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Declaration

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Abstract

South African local government is marred by many problems relating to governance. Because of these problems, it is necessary to explore the effectiveness of the Internal Audit Function (IAF) in assisting management with governance within local government. Research has shown a positive relationship between the characteristics of corporate governance and the IAF. This study sets out to establish the effectiveness of the IAF as part of a sound corporate governance structure at the Saldanha Bay Municipality (SBM) during the period 2009/2010 to 2017/2018. A qualitative approach utilising the case study method was employed.

Data was collected from municipal documents, as well as from unstructured interviews to corroborate the document analysis. The findings of this study highlight the challenges experienced by the IAF. The study found that the IAF lost skills and competencies repeatedly due to resignations. These staff shortages hampered the quality of work of the IAF, and prevented the IAF from being subjected to external quality assessments for the duration of the study. The low implementation rate of IAF recommendations is a cause for concern which contributes to repeat findings by the IAF and AGSA.

The study also found that the IAF has two reporting lines - functionally to the audit committee (AC) and administratively to the municipal manager (MM), in accordance with best practice requirements. Although the IAF is not viewed as a strategic partner, but rather a supporting function of management, the support from the AC and MM may be utilised to improve governance at the SBM. The SBM can utilise the results of this research for purpose of reviewing current institutional management practices, and also as a benchmark for improvement of such practices. The findings and observations of this study may also assist other municipalities conducting a similar exercise.

Key terms:

Internal audit function; corporate governance; internal audit effectiveness; combined assurance; quality assurance and improvement program.

Opsomming

Plaaslike regering in Suid-Afrika word deur talle bestuursprobleme geteister. As gevolg van hierdie probleme is dit nodig om die effektiwiteit van die Interne Oudit Funksie (IOF) te ondersoek om vas te stel in hoe 'n mate dit bestuur op plaaslike regeringsvlak ondersteun. Navorsing het 'n positiewe verwantskap tussen die eienskappe van korporatiewe bestuur en die IOF gevind. Hierdie studie het as doelwit die bepaling van die effektiwiteit van die IOF as deel van 'n gesonde korporatiewe bestuurstruktuur in die Saldanhabaai Munisipaliteit (SBM) gedurende die tydperk 2009/2010 tot 2017/2018. 'n Kwalitatiewe metodologie met 'n gevallestudie metode is gebruik om die navorsing te doen.

Data is vanuit munisipale dokumente verkry, terwyl ongestruktureerde onderhoude benut is om die resultate van die dokumentestudie te verifieer. Die resultate van die studie beklemtoon die uitdagings verbonde aan die gebruik van die IOF. Die navorsing het bevind dat, as gevolg van bedankings, die vaardighede om die IOF effektief te bedryf herhaaldelik gekortwiek is. Personeeltekorte, wat as gevolg van hierdie bedankings ontstaan het, het die kwaliteit van die IOF se werk belemmer en verhoed dat die IOF aan eksterne kwaliteitsevaluering gedurende die duur van die studie blootgestel kon word. Die lae implimenteringsfrekwensie van die IOF-aanbevelings is ook 'n rede tot kommer en het bygedra tot herhalende bevindinge deur die IOF en Ouditeur-Generaal van Suid-Afrika (OGSA).

Die studie het ook bevind dat die IOF twee rapporteringskanale het, naamlik 'n funksionele kanaal na die oudit komitee (OK) en 'n administratiewe kanaal na die munisipale bestuurder. Hierdie twee kanale bestaan sodat aan Beste Praktykvereistes voldoen kan word. Hoewel die IOF nie as 'n strategiese vennoot gesien word nie, maar eerder as 'n ondersteuningsfunksie vir bestuur, kan die ondersteuning van die OK en die munisipale bestuurder gebruik word om bestuur by die SBM te verbeter. Die SBM kan hierdie navorsingsresultate gebruik om te besin oor bestaande bestuurspraktyke en ook as maatstaf vir verbetering van sodanige praktyke. Die bevindinge en waarnemings van hierdie studie kan ook deur ander munisipaliteite wat 'n soortgelyke oefening wil onderneem, gebruik word.

Sleutelwoorde:

Interne ouditfunksie; korporatiewe bestuur; interne ouditeffektiwiteit; gekombineerde versekering; kwaliteitsversekering en verbeteringsprogram.

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List of Acronyms

AC	Audit Committee
ACC	Audit Committee Chair
AGSA	Auditor-General South Africa
CAE	Chief Audit Executive
CBOK	Common Body of Knowledge
CG	Corporate Governance
CIPFA	Chartered Institute of Public Finance and Accountancy
COSO	Committee of Sponsoring Organizations of the Treadway Commission
DoRA	Division of Revenue Act
ECIIA	European Confederation of Institutes of Internal Auditing
Framework	Internal Audit Framework
IAASB	International Auditing and Assurance Standards Board
IAF	Internal Audit Function
IFAC	International Federation of Accountants
IIA	The Institute of Internal Auditors
IIA Australia	The Institute of Internal Auditors Australia
IIARF	The Institute of Internal Auditors Research Foundation
IoDSA	Institute of Directors Southern Africa
IT	Information Technology
King I	King Report on Corporate Governance and the Code of Corporate Practices and Conduct, 1994
King II	King Report on Corporate Governance and the Code of Corporate Practices and Conduct for South Africa, 2002
King III	King Code of Governance Principles for South Africa, 2009
King IV	King IV Report of Governance for South Africa, 2016
MFMA	Municipal Finance Management Act
MM	Municipal Manager
OECD	Organisation for Economic Co-operation and Development
PSACF	Public Sector Audit Committee Forum
RBIAP	Risk-based Internal Audit Plan
RSA	The Republic of South Africa
SBM	Saldanha Bay Municipality

Standards

International Standards for the Professional Practice of Internal Auditing

CHAPTER 1

INTRODUCTION AND ORIENTATION OF THE STUDY

1.1 INTRODUCTION

This chapter includes the background, problem statement, and objectives this study intends to achieve. The research design and methodology employed to achieve the objectives is discussed briefly, followed by the limitations of the study and the outline of the chapters.

1.2 BACKGROUND AND RATIONALE FOR THE STUDY

Corporate governance is the term used internationally to describe how entities are directed and controlled to benefit all the stakeholders (Naidoo, 2002:1). Corporate governance has received increasing attention over the past decades for various reasons. Some of the reasons are the scandals that have surfaced in the private and public sectors, for example, the fall of Enron in 2001 (Vinten, 2002) and recent and ongoing service delivery protests in municipalities in South Africa. All these occurred, *inter alia*, because of financial mismanagement and lack of corporate governance. The increased focus on corporate governance resulted in different codes being developed around the world, taking each country's circumstances into account (King, 2006:2). Examples of these codes are the Cadbury Report in the United Kingdom, the Sarbanes-Oxley Act in the United States of America, and the King Report on Corporate Governance in South Africa (King, 2006:2-3).

Entities exist to create wealth for stakeholders. To achieve this aim and address the failures in corporate governance, a board of directors consisting of both executive and non-executive directors is employed. This board is guided by corporate governance principles in performing their duties (King, 2006:35). Members of the board experience many challenges in performing their duties due to a lack of sufficient combined and individual knowledge. This is evidenced in year-end statements that are not comprehensive enough to be understood by the non-executive directors. Consequently, the non-executive director must obtain assurance on the quality and completeness of the information at board level (King, 2006:65-66). Principle 15 in King IV Report of Governance for South Africa, 2016 (King IV) requires the governing body to ensure that assurance services and functions exist to enhance a well-functioning control environment that will support the accuracy of information for internal

decision making and external reporting. One of the most important tools for accessing this assurance is internal auditing (IoDSA, 2016:68).

Internal auditing is a profession that renders independent and objective quality assurance and consultancy work to add value and to improve the entity's operations (Pickett, 2005:109). Practitioners of internal auditing are normally organised in a department, division, or team and are thus referred to as an internal audit activity or function (IAF). The IAF may be in-house, outsourced, or co-sourced (Coetzee, du Bryn, Fourie & Plant, 2012:2). The employees in this profession need to possess an in-depth understanding of the purpose of the entity and its culture, systems, and processes. With this in-depth knowledge, the IAF plays an integral role in the creation and execution of logical and efficient methods used to evaluate and improve the effectiveness of risk management, control, and governance processes to accomplish organisational objectives (Sawyer, Dittenhofer & Scheiner, 2003:10). This solidifies the IAF as a vital part of governance and a treasure to organisations (Janse van Rensburg & Coetzee, 2015:181).

Previous corporate governance codes focused mainly on the private sector, however, the King IV addressed this through specific references to the public sector. Included in King IV is the sector supplement specifically for municipalities. In the public sector, corporate governance refers to the associations and connections that exist between national, provincial, and local authorities and the public they serve. The outcome of this relationship should be the improvement of the general welfare of the public through service delivery. For services to be delivered, priorities should be set, funding for these projects should be acquired, and the expenditure thereof monitored and controlled (Du Toit *et al.*, 2002:64). However, this is not always the case. Consequently, corporate governance has become a very topical issue in public sector service delivery.

There are many problems identified in local government, for example, qualified audit reports and the awarding of tenders through nepotism (De Villiers & Michel, 2007:35). Most of these problems resulted in service delivery protests (Mbura, 2013; Pule, 2014; Sepuru, 2017; Brandt, 2018; Mamaile, 2018; Maregele, 2018). Based on these, it is necessary to explore the effectiveness of the IAF in assisting management with governance within local government. Research by Karagiorgos, Drogas, Gotzamanis and Tampakoudis (2010:20) established the positive relationship between the characteristics of corporate governance

and the IAF. However, the researchers encouraged that further studies be conducted to evaluate the exact and possible impact of the IAF on corporate governance.

This study will analyse the effectiveness of the IAF as part of a sound corporate governance structure at the Saldanha Bay Municipality (SBM). The SBM (with Municipal Demarcation Board code WC014) is a local municipality of the Western Cape Province of South Africa. It is located on the West Coast and serves the communities in St Helena Bay, Jacobsbaai, Paternoster, Saldanha, Hopefield, Vredenburg, and Langebaan (Saldanha Bay Municipality, 2019). The municipality is predominantly (96.8%) urban and had a total population of 99 193 people according to the 2011 Census (Department Statistics South Africa, 2011).

SBM experienced service delivery protests in the past. One of the root causes for these protests were political instabilities that had a negative impact on the administration and management as established by Du Plessis (2016:4) in his study on performance management at SBM. These service delivery protests are still continuing as reported by Brandt (2018) and Maregele (2018). With the existence of the IAF at SBM, one tends to wonder what role they play to strengthen governance at SBM. To achieve the objectives of this study, the literature on corporate governance and internal auditing is explored in Chapter 2 and Chapter 4 reflects the analysis of the input, processes and output of the IAF at SBM.

1.3 PROBLEM STATEMENT

Corporate governance plays an important role in the contemporary South African context, in both the private and public sectors. The South African public sector structures comprise of the national, provincial, and local government with their respective responsibilities. The local government exists to bridge the gap between national and provincial governments and the public they serve (Erasmus & Coetzee, 2017:86).

Local government operates in a complex, rapidly changing environment and needs to balance various challenges including financial constraints, and demands from various stakeholders including politicians, legislatures, business and the public (Governmental Accounting Standards Board, 2013:13, 33). The same notion is shared by the Medium Term Strategic Framework (MTSF). The MTSF states that municipalities operate in complex environments with many challenges that include the lack of institutional capacity, corruption and lack of performance with limited consequence management, weak financial

management, and lack of oversight and accountability (Department Planning, Monitoring and Evaluation 2014:2)

Despite all the government regulations and guidelines available in South Africa, there are still complaints of poor management of funds and lack of service delivery within government departments and local government (Erasmus & Coetzee, 2018:91). The funds are either missing or cannot be accounted for, spending has been unauthorised or was fruitless and wasteful, resulting in the issuing of qualified audit reports, auditing disclaimers, or adverse audit opinions. Therefore, internal auditing plays a critical governance role within this environment and should become the right hand of the governing body as stated by King (European Confederation of Institutes of Internal Auditing, 2009:2).

The Auditor-General of South Africa (AGSA) is the key assurance provider established to facilitate oversight, accountability, and governance in the public sector (AGSA, n.d.:ii; RSA, 2004). One of the main findings on governance by the AGSA reported in the General Report on audit outcomes of Western Cape Local Government for 2008-09 was that ineffective internal audit units contributed to lapses in governance. This ineffectiveness of internal audit units resulted from vacancies, inappropriate knowledge, skills, and experience of internal auditors, and audit plans that are not informed by risk assessments. SBM was one of the municipalities with this finding (AGSA, 2010:5-6). In the financial year 2017-18 report, the AGSA identified that accountability for financial and performance management continued to deteriorate over the years, despite many recommendations for improvement presented in previous reports. One of the main indicators for this continued deterioration was the increasingly difficult environment for auditors (external) and other role players in accountability, internal auditing being one. Their contribution to governance does not have an impact because their recommendations are not implemented (AGSA, 2019:9; 28). SBM was still not an exception as the Audit Committee (AC) highlighted that there were still recurring, unresolved internal audit findings (Saldanha Bay Municipality, 2018a:148).

Many studies investigated the effectiveness of the IAF to support corporate governance (Erasmus & Coetzee, 2018; Lenz, Sarens & Hoos, 2017; Tadesse, 2015; Hailemariam, 2014; Fourie, Plant, Coetzee & van Staden, 2013; Sosthenes, 2013; Saud & Marchant, 2012; Soh & Martinov-Bennie, 2011; Yee, Sujun, James & Leung, 2008; Whitley, 2005), including within municipalities (Mamaile, 2018; Erasmus & Coetzee, 2017; Mbewu & Barac, 2017; Sepuru, 2017; Pule & Assan, 2016; Ayagre, 2015; Motubatse, Barac & Odendaal,

2015; Barac & van Staden, 2014; Pule, 2014; Masui, 2013; Njoroge, 2012; Asare, 2009; Mihret & Yismaw, 2007; Mjikayo, 2006 ; van Gansberghe, 2005). However, there is limited research on the role of the IAF within sound corporate governance as a single case study, and none at SBM. With local government in South Africa experiencing numerous problems that hinder sound corporate governance practices and with the IAF being in an ideal position to assist management in this regard, the effectiveness of the IAF as part of a sound corporate governance structure at SBM has not been established.

Therefore, the importance of good governance in the public sector and the strategic role of the IAF as recommended by King IV, together with the findings by AGSA, prompted an exploration of the effectiveness of the IAF at SBM.

1.4 PURPOSE OF THE STUDY

This study's focus is to establish the effectiveness of the IAF as part of a sound corporate governance structure at the SBM during the period 2009/2010 to 2017/2018.

The specific objectives are to:

- Determine the structure and composition of the IAF and its impact within the SBM; and
- Determine the support rendered by the IAF to the management of the SBM as part of their governance role during the period 2009/2010 to 2017/2018.

The research questions formulated for this research are:

- How does the current structure and composition of the IAF impact the corporate governance structure at the SBM?
- How has the IAF supported management in governance during the period 2009/2010 to 2017/2018?

The results of the research will be used to make recommendations for use within the SBM.

1.5 RESEARCH DESIGN AND METHODOLOGY

This study follows a qualitative research strategy with its research design centred on an exploratory case study of one selected municipality. The unit of analysis is thus restricted to

one chosen local government structure. According to Bryman (2004:48) and Rule and John (2011:4), the type of research that is based on a single community or organisation conducted in its own milieu to generate knowledge constitutes a case study. Welman and Kruger (2001:1) agree and confirm that a case study investigates the dynamics of an institution. The unit of analysis in this selected case study will be the IAF of the SBM.

1.5.1 Data collection

When collecting data for qualitative research, it is important to show that there is triangulation. Triangulation necessitates the use of more than one method or source of data so that findings may be cross-checked (Bryman, 2004:275; Rule & John, 2011:108-109). Ryan, Scapens and Theobald (2002:154) agree and highlight the importance of using multiple sources of evidence to allow issues and theories to emerge in the study. The data collected for this study is from different types of literature and documentation available and interviews with various stakeholders that interact with the IAF.

1.5.1.1 Literature review

An in-depth study of the literature was conducted. Its foundation focused on primary and secondary sources. The primary sources included annual reports of the municipality, minutes of (AC) meetings, internal audit charters and internal audit reports. Secondary sources included the legislative and policy framework applicable to municipalities, the AGSA general outcome reports over the period 2009/10 – 2017/18, academic articles on internal auditing focusing on the public sector, professional literature issued by inter alia the Institute of Internal Auditors (IIA), books, dissertations and theses, government publications, and guidelines, bulletins and presentations.

1.5.1.2 Interviews

For triangulation purposes, interviews were conducted with two CAEs (past and present), a previous IAF employee, an outgoing AC chairperson (ACC) (followed up with an informal discussion with the current ACC), as well as three members of executive management.

1.5.2 Data analysis

This study is purely qualitative. The categories for data analysis were derived from the literature review for the qualitative analysis of data collected from municipal records and interviews. The outcome of the interviews and information obtained through the literature

study and document analysis were compared with the requirements for the IAF as part of corporate governance in local government.

1.6 LIMITATIONS OF THE STUDY

The study is conducted within the parameters of the corporate governance requirements for internal auditing as stipulated in the King Report on Corporate Governance for South Africa (emanating from King III through to additional requirements as per King IV). The period covered in the study span from the financial year 2009/2010, when the King III was issued, through to the financial year 2017/18, two years after King IV was released.

The research is limited to municipal documents followed up by unstructured interviews with selected members from management, the ACC, and members within the IAF. This selection of interviewees is based on the management's implementation of internal audit recommendations as this has a direct effect on the role of the IAF in ensuring that the municipality is a good corporate citizen. Obtaining information from the municipality and securing interviews proved somewhat difficult due to the work schedules of IAF personnel and management. However, with regular follow-ups the information required was eventually obtained. A total of three of the five directors were interviewed, although the interview with the current Municipal Manager (MM) was abandoned since the incumbent was not with the SBM during the period 2009/10 to 2017/18.

The results of this research cannot be generalised to other municipalities because the context of each municipality is different.

1.7 TERMINOLOGY

Corporate governance is defined as 'the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the organization's activities toward the achievement of its objectives' (IIA, 2012:5).

The *public sector* consists of all governments (international, national, regional, or local) and all publicly controlled or funded organisations tasked with delivering services (IIA, 2011:3).

Public sector governance 'relates to the means by which goals are established and accomplished. It also includes activities that ensure a public sector entity's credibility,

establish equitable provision of services, and assure appropriate behaviour of government officials — reducing the risk of public corruption’ (IIA, 2012:5).

The *internal audit function* is ‘an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes’ (IIA, 2018:1). The IIA speaks about the internal audit activity, however, for this study, the term internal audit function is preferred as it is used in most of the literature consulted.

Internal audit effectiveness refers to ‘the degree (including quality) to which established objectives are achieved’ (IIA, 2010a:2).

1.8 OUTLINE OF THE STUDY

The study will be arranged in the following chapters:

Chapter 1: Introduction and orientation of the study

The chapter provides the background and general information regarding the study. This includes the objectives of the study, the description of the methodology utilised, and the outline of the study with a brief outline of the chapters.

Chapter 2: Corporate governance requirements for the internal audit function

This chapter introduces the available current literature used in the study to assist with the qualitative analysis of the data collected. It provides an in-depth look at the literature review on corporate governance and the role that the IAF plays in making an organisation a good corporate citizen. This provides insight into the relevance of the material to the problem statement.

Chapter 3: Research design and methodology

In this chapter, the research design and methodology adopted for the study are discussed, and includes the data gathering methods as well as the data analysis technique utilised.

Chapter 4: Case study: Saldanha Bay Municipality

This chapter analyses the data collected from municipal documentation and the interviews conducted. The data is interpreted and presented as results. The discussion of the results is guided by the research design and method identified in Chapter 3.

Chapter 5: Conclusions and recommendations

The last chapter addresses the achievement of the research aim and objectives and presents a summary of the research findings as well as recommendations for improvement.

1.9 CONCLUSION

The above chapter has discussed the background to the research topic. The purpose and relevance of the study were put into perspective and the research objectives and research questions were identified. The research design and method adopted for the study were discussed briefly, as well as the layout of the chapters in the study.

Chapter 2 follows with the literature review on corporate governance requirements for internal auditing and starts with the meaning of corporate governance.

CHAPTER 2

CORPORATE GOVERNANCE REQUIREMENTS FOR THE INTERNAL AUDIT FUNCTION

2.1 INTRODUCTION

The following chapter addresses the descriptions and meanings of corporate governance, those of the IAF within the corporate governance realm, and the relationship that exist between the two concepts. Thereafter, the requirements for the IAF within local government are reflected upon, based on the legislative framework and other guidance documents. The chapter also reflects on the different role-players and their influences on the IAF and includes a summary of other postgraduate studies on the topic of this thesis.

The objectives of the study introduced in Chapter 1 focus on determining how the structure and composition of the IAF at the Saldanha Bay Municipality impact governance. This is followed by determining the support rendered by the IAF to management as part of their governance role within the municipality during the period 2009/10 to 2017/18. This chapter intends to provide insight into the literature relevant to the problem statement. The review is informed by a search of relevant databases, journals, scanning references in papers and books, and inquiries of experts on the topic.

The information and data obtained in the literature review inform the type of data to be collected in accordance with the methodology selected for the study. The broader context in which the IAF operates within the corporate governance environment in the public sector positions this research within the local government sphere. The chapter concludes by identifying possible shortcomings in IAF to support governance arrangements as well as challenges experienced by internal auditors.

2.2 DESCRIBING CORPORATE GOVERNANCE

The descriptions and definitions of corporate governance have evolved and this section includes some of the narratives demonstrating the evolvement. Through public sector organisations, governments produce goods and services and regulate the producers of these commodities in the private sector. This promotes issues of accountability and good governance in ensuring economic development (Ayagre, 2015:40). Stemming from this

implication is the fact that corporate governance has received increasing attention, internationally and locally, in both the private and public sectors over the past decades for various reasons, including financial scandals and fraud. One factor that led to the increased attention to corporate governance was the need to separate management from ownership control in organisations – also known as the principal-agent problem (agency theory) – where the stakeholder interests' conflict with those of management (Khan, 2011:2).

The Organisation for Economic Co-operation and Development (OECD) defines corporate governance as the system that 'provides structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined (OECD, 2015:9). Oman agrees and expands the definition of the OECD to include private and public institutions and explains that a combination of laws and regulations together with business practices are aimed at governing the relationship between managers and entrepreneurs on one hand and those who invest resources on the other (Oman, 2001:13).

As a result, corporate governance systems, processes, and structures aim to ensure that the entity complies with legal and regulatory requirements through systems of accountability, risk management, and controls. The ongoing monitoring of these systems, processes, and structures occurs within the approved constraints of an entity and are said to be evolutionary. Therefore, they need to be improved upon occasionally to a point where they become best practices (OECD, 1999:6-8).

The increased focus on corporate governance has resulted in different codes and legislation being developed around the world, taking each country's circumstances into account (King, 2006:2). A few examples of these codes and reports are summarised by Marx (2008:97-207) and Cascarino and van Esch (2007:180-181) to include the following:

- the United Kingdom:
 - the Cadbury Report (1992), Greenbury Report (1995), Hampel Report (1998), Combined Code (1998 with updates in 2003 and 2006), Turnbull Report (1999), Smith Report (2003) and Higgs Report (2003).

- the United States:
 - Federal Deposit Insurance Corporation Improvement Act (1991), Committee of Sponsoring Organisations of the Treadway Commission (1992 with updates in 1999 and 2004), The Institute of Internal Auditors (1993, with updates in 2000 and 2005), American Law Institute (Principles of Corporate Governance: Analysis and Recommendations - 1994), Statement on Corporate Governance (1997), the Blue Ribbon Report (1998) and the Sarbanes Oxley Act promulgated in 2002.

- Germany:
 - the Cromme Code was issued in 2002.

- France:
 - the Bouton report was released in 2002.

- Australia:
 - the Bosch Report (1991 with updates in 1993 and 1995), Hilmer Report (1993 updated in 1998), Australian Investment Managers Association Guide on Corporate Governance (1995 with updates in 1997, 1999, 2002 and 2004), Commonwealth Association for Corporate Governance Guidelines (1999), Organisation for Economic Co-operation and Development Principles of Corporate Governance (1999 with updates in 2004) and the HIH Royal Commission (The Owen Report in 2003).

- South Africa:
 - the King Report on Corporate Governance and the Code of Corporate Practices and Conduct (King I – 1994), Protocol on Corporate Governance for State-Owned Enterprises (1997 updated in 2002), King Report on Corporate Governance and the Code of Corporate Practices and Conduct for South Africa (King II – 2002), the King Code of Governance Principles for South Africa (King III – 2009), and the King IV Report of Governance for South Africa (2016).

In the different King codes, the Institute of Directors Southern Africa (IoDSA) defines corporate governance as a simple arrangement used by companies for directing and controlling an organisation (IoDSA,1994:1) and is in essence about leadership that is comprehensive and open to institutional involvement whilst focusing on non-financial aspects of its performance (IoDSA, 2002:19-20). It “involve(s) the establishment of structures and processes, with appropriate checks and balances that enable directors to discharge their legal responsibilities, and oversee compliance with legislation” (IoDSA, 2009a:6), and has been seen recently as an “exercise of ethical and effective leadership – that complement and reinforce each other – by the governing body towards the achievement of governance outcomes, namely ethical culture, good performance, effective control and legitimacy” (IoDSA, 2016:20). Naidoo agrees with the importance of ethical culture that should exist within an organisation and its evolution and improvement as the organisation matures. The purpose of corporate governance systems, structures, and processes is to ensure that an objective employment of power within an entity is sustained to strike a balance between economic, social, individual, and collective goals (Naidoo, 2002:1-2).

Though the term ‘corporate’ is mostly used to refer to legally incorporated organisations, in South Africa the corporate governance requirements applicable to the private sector equally apply to the public sector (IoDSA, 2016:6). The Department of Public Enterprises adopted the corporate governance definition from the King II to the public sector by explaining that corporate governance structures consist of “processes and systems by which corporate enterprises are directed, controlled and held to account” (Department: Public Enterprises, 2002:3).

Corporate governance thus entails all mechanisms, both regulatory and non-regulatory, that are put in place to ensure that the management of an organisation, as well as their supporting structures, are held to account. These mechanisms will ensure that the objectives of an organisation are met economically and efficiently. The control characteristics of corporate governance equate to being compliant, accountable, and transparent in the functioning of the entity (Bilal, Twafik & Bakhit, 2018:260-261).

Different theoretical lenses are used in studies on internal auditing and its effectiveness as part of the corporate governance structure. Examples include the agency theory, the institutional theory and communication theory. The agency theory refers to the contract between agents and principals, the institutional theory focuses on the influence of internal

and external factors on the organisational structure, and the communication theory focuses on the need for effective communication within organisations (Endaya & Hanefah, 2013:93-95). The agency theory has been used as a theoretical lens in most of the studies analysed as part of the research review (Erasmus & Coetzee, 2017:86; Carcello, Hermanson & Ye, 2011:19; McNulty, Zattoni & Douglas, 2013:195).

To mitigate the principal-agent problem necessitates good working relations between the stakeholders, the board and management. This relationship yields the pursuit of objectives that are in the best interest of the stakeholders (the public). Therefore, governance mechanisms in place for local government in South Africa are the AC and the IAF as they are expected to provide reasonable and autonomous advice to improve oversight, governance and to assist in risk modification (Department: National Treasury, 2012:2). Thus, corporate governance operates on the notion that those in charge, function best when they are held to account (Cascarino & van Esch, 2007:183) and the IAF is the best option to shape this form of accountability as explained further in section 2.3.

The agency theory in the context of this study can be explained in that the IAF is appointed by the principal (MM in consultation with the AC representing council) to perform monitoring and consulting functions including internal control training and advising on control concerns, e.g. drafting policies. The dual functions of the IAF include assisting in monitoring the performance of the agent (management) and in supporting management to improve processes to contribute towards improved governance (IIA, 2003:106). Therefore, through the IAF's functional reporting to the independent AC (representing council – the principal) the IAF assist, the principal to monitor the agent (management) to ensure management fulfils their responsibilities effectively and through recommendations and value-adding interventions assist management to improve control processes and governance.

This research focuses on the effectiveness of the IAF as part of a sound corporate governance structure and specifically how the structure and composition of the IAF impacts effectiveness and the support provided by the IAF in improving governance within the municipality. The agency theoretical lens is therefore appropriate to be used as a basis for this research. Having reflected on the meaning and evolvement of corporate governance, the next section describes the meaning of internal auditing as part of corporate governance and demonstrates the relationship between the two concepts.

2.3 DESCRIBING INTERNAL AUDITING

Internal audit is a critical function in organisational governance (Ramamoorti, 2003:13-14) and its existence within organisations is a legislative requirement (Erasmus & Coetzee, 2009:926; Mbewu & Barac, 2017:17). As part of governance, the IAF should monitor risks and ensure the reliability of financial reporting (Holt & De Zoort, 2009: 61). Other researchers agree that the IAF is a critical corporate governance mechanism established to monitor organisational risks and assess controls thereby playing an important role in organisational governance (Gramling, Maletta, Schneider & Church, 2004:196; Carcello, Hermanson & Raghunandan, 2005:71; Sarens, De Beelde & Everaert, 2009:90; Carcello *et al.*, 2011:8; Soh & Martinov-Bennie, 2011:606).

The definition and role description of internal auditing has developed over the years. During ancient times, internal auditing was viewed as a means of confirming the accuracy of financial statements by way of checks and balances. Although the internal auditing profession started as an extension of accounting; it has since progressed into a well-recognised management-oriented profession. Due to modernisation and the increased complexity of economic structures, the performance of simple checks and balances were no longer deemed sufficient. The expansion in the size and complexity of organisations kept management away and this resulted in the impossibility of close monitoring of employees' activities. This development led to internal auditing becoming a central function to assist management and other stakeholders in the monitoring of activities performed within organisations (Sawyer, 1974:2; Sawyer *et al.*, 2003:3-5; van der Nest, 2006:105-106; Cascarino & van Esch, 2007:3-5; Coetzee *et al.*, 2012:3).

One of the first definitions for internal auditing included in the first Statement of Responsibilities of Internal Auditing in 1947 states that "internal auditing is an independent appraisal function established within an organisation to examine and evaluate its activities as a service to the organisation". From this definition, the statement of objective and scope was issued with the purpose of "assisting members of the organisation, including that in management and on the board, in the effective discharge of their responsibilities by furnishing them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed, the audit objective including promoting effective control at reasonable cost". However, with this definition, the emphasis was only on compliance with policies and procedures, and feedback on non-compliance (Coetzee *et al.*, 2012:10).

The developments in business processes and the extensive accessibility of information necessitated the need to transform resulting in a revised definition of internal auditing. The Guidance Task Force commissioned in 1997 examined the global internal audit profession, internal audit knowledge, and the future of the profession and in 1999, a new definition for internal auditing was approved. Internal auditing was thus defined as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes” (Coetzee *et al.*, 2012:10).

This definition agree with Sawyer *et al.*’s explanation that internal auditing aims to appraise the operations and controls of an organisation systematically and objectively. This approach is necessary to ascertain the accuracy and reliability of financial and operational information, assess the identification and management of the risks of an organisation, review compliance to regulations and policies, evaluate compliance with operating criteria, and measure the efficient, effective and economic use of resources to achieve the organisation’s objectives (Sawyer *et al.*, 2003:3).

The role of the IAF thus expanded from simply providing independent review services on the financial system controls (Coupland, 1993:4) to providing value-adding assurance and consulting services (Bou-Raad, 2000:182) to enhance internal control systems and ensure that systems produce quality information to assist management in decision-making. Mihret and Yismaw (2007:471) argue further that the essence of the contribution made by internal auditors remains the improvement of internal controls with its emphasis shifting from providing accountability on past transactions to focusing on the future improvement of outcomes.

The value-adding role of the IAF is emphasised in the literature on internal audit (Schleifer & Greenawalt, 1996:5; Bookal, 2002:46; Roth, 2003:35; Whitley, 2005:21; Hass, Abdolmohammadi & Burnaby, 2006:836; Gramling & Hermanson, 2006:37; Barac, Plant & Motubatse, 2009:980; Ray, 2009:5) and it is a part of the added responsibility of providing consulting services. This allows the IAF to transform its role from being a ‘watch dog’ to that of a ‘guide dog’ (Coetzee *et al.*, 2009:11). The value-adding role is thus incorporated in the Internal Audit Framework (Framework) issued by the National Treasury. The Framework also regards the consulting services as a value-adding service aimed at helping

management with solving problems to achieve organisational objectives (Department: National Treasury, 2009:71). This also proves that the IAF is a key factor in ensuring that the organisation is effectively managed and that the resources are used effectively and efficiently and not misused or misappropriated.

Throughout the literature, various areas in which internal auditing can add value as part of assurance engagements and consulting activities have been identified. Areas in the assurance terrain include financial, performance, compliance, system security, and diligence audits, and for consulting engagements, value-adding activities can include internal control training, advising management about control concerns, drafting policies and participating in quality teams (Hass *et al.*, 2006:837; Motubatse, 2014:30).

Internal auditing has a key role to play as part of governance to support and advance the objectives set by the governing body. This is done by providing a critical assurance function over the accuracy and reliability of data, governance, risk management and control across the entity. By reviewing the design and effectiveness of the different components of governance, internal auditors provide assurance, insight, and advice. The reviews must include the organisational culture and the behaviour of employees and management (IFAC & IIA, 2018:6-7). On the other hand, Ray, by referring to the study performed by the IIA on the Common Body of Knowledge (CBOK) in 2006 identified the criteria enabling the IAF to add value as being independence, objectivity, understanding of the core value proposition, strategy, vision and values, and competency of the audit staff. Ray further indicates that value-adding services can be measured by an effective quality review process (Ray, 2009:10).

To meet the requirements incorporated in the definition and descriptions of internal auditing, internal auditors need to possess an in-depth understanding of the objectives and mandate of the entity, its culture, systems, and processes. The in-depth knowledge enables the internal auditors to play an integral part in the development and execution of logical, effective, and efficient methods, and procedures that support good governance. These methods and procedures are applied in the assessment of areas including risk management, control and governance processes to make recommendations for improvement thereby contributing towards the achievement of the objectives set for the organisation (Sawyer *et al.*, 2003:10). In the areas of risk management, governance and internal controls, the internal auditor assists and adds value to management and the governing body by conducting

evaluations on the existing mechanisms (Coetzee, 2016:354). The outcome of these evaluations should result in recommendations for improvements where inadequacies are found (Department: National Treasury, 2009:7-8).

The above discussion on the description and evolvement of internal auditing demonstrates the expansion in the scope of work performed by internal auditors. More than merely providing assurance on historical activities, internal auditors are now required to provide consulting services, transforming from being watchdogs to guide dogs. The IAF is now required to add value to the organisations' governance processes, risk management and internal control. In practice, some confusion still exists on the difference between the roles of internal audit versus that of the external audit. The following section attempts to clarify and explain the difference.

2.4 INTERNAL AUDIT VERSUS EXTERNAL AUDIT

The IAF came into being in the early 1900s when the specialisation in auditing resulted in a divide into two professions, namely internal and external auditing. The internal audit profession started with the role of testing the reliability of the information in financial statements (Coetzee *et al.*, 2012:3-4) but evolved to include other areas, alluded to in the description of internal auditing.

Cascarino and van Esch (2007:4) clarify the distinction between external and internal auditing. The main distinction being that the external auditor has a responsibility towards the external parties of the organisation whilst the internal auditor's responsibility is towards the organisation and its stakeholders. The internal auditor plays a role in assisting management in the performance of their duties by ensuring that internal control structures are functional given the level of risk.

Pickett (2005:4) concurs and elaborates that the role of the external auditor is to examine financial records and give an opinion that the financial records have been fairly presented. Jackson and Stent (2010:1/2) agree and explain that the external auditor expresses an independent opinion and is not an employee of the organisation being audited. The internal auditor, on the other hand, can be an employee of the organisation. The internal auditor performs independent assignments for the organisation and must be autonomous to the division where the assignment is being performed. Internal auditors thus act as internal

control, risk, and corporate governance advisors within the organisation (Cascarino & van Esch, 2007:5; Pickett, 2005:4).

The purpose of internal auditing is to assist management to achieve their objectives and to add value to the organisation by independently evaluating the adequacy and effectiveness of governance, risk management and control processes. It is therefore necessary that the competencies and skills of internal audit are aligned with the mandate of the organisation in which they operate as alluded to by Fourie, *et al.* (2013:76). The research study focusses on internal audit at local government level. It is therefore appropriate to consider the difference (if any) in the roles and responsibilities of internal auditors in the private versus the public sector and is discussed in the next section.

2.5 PRIVATE SECTOR VERSUS PUBLIC SECTOR INTERNAL AUDIT

Most of the research on internal auditing focus on the private sector (Gabrini, 2013:24; Barac & van Staden, 2014:18) and it is necessary to understand the differences and relationship between internal auditing in the private sector and public sector to rely on the available research. Barac and van Staden recognise that although there are important differences between internal auditing in the private versus the public sectors, changes and reforms in the public sector have reduced the extent of the differences specifically related to governance (2014:18).

Cascarino and van Esch differentiate between corporate governance in the private sector versus the public sector. In the private sector, corporate governance represents “the relationship among various participants in determining the direction and performance of companies and involves shareholders, management and board of directors” (2007:7) and within the public sector (government) structures, the term corporate governance represents a “collection of practices aimed at ensuring management accountability and service delivery” (2007:184).

Private sector internal auditors assist the organisation in fulfilling their mandate of profit making and increasing shareholder value, whilst internal auditors in the public sector are tasked with assisting organisations to achieve the objective of providing services to the public effectively, efficiently and economically. Goodwin completed research on the extent to which internal auditing in the public sector differ from that in the private sector related to status, scope, and activities. In this research, the results from the data collected through

questionnaire surveys sent to chief internal auditors in organisations in Australia and New Zealand indicate that there are differences in the status between internal auditing in the private versus public sector. However, the activities performed by internal auditors are similar and the interactions with external audit are also comparable (Goodwin, 2004:640-641). In terms of status, the study results indicate that public sector IAFs have a higher status than that of the private sector in that more than a third of the chief internal auditors report to the chief financial officer (Goodwin, 2004:648). Due to the expansion in the definition of governance and internal auditing it is possible to rely on the body of knowledge on internal auditing as part of the empirical research whether in the private or public sector.

Asare also recognises that as a result of the strategic role of internal auditing that shifted from merely auditing transactions before payment, it also became an essential component of public sector governance and financial reform in many developing countries (2009:15). Within the public sector the fundamentals of internal auditing namely risk management, control and governance can be further explained by the following: “Risk management, control and governance encompass the policies, and procedures established to ensure the achievement of objectives and include the appropriate assessment of risk, the reliability of internal and external reporting and accountability processes, compliance with applicable laws and regulations and compliance with behavioural and ethical standards set for public organizations and employees” (Asare, 2009:19).

The South Africa local government is subjected to continuous protests and complaints due to the lack of service delivery (Mamaile, 2018:2), and the SBM is not immune to such activities (Brandt, 2018; Maregele, 2018). There has been an increased focus on the accountability, effectiveness, and efficiency of services provided by public sector organisations (Renz, 2010:125, 134). Residents demand more transparent and better services, whilst resources are growing at a slower pace. The existence of this imbalance presents unique risks to the public sector and provides an opportunity for internal auditing in the public sector to add value in the important area of corporate governance and the need for accountability (Janse van Rensburg & Coetzee, 2015:182).

The importance of internal auditing in the context of local government is capsulated by the following extraction from Circular 65: “Therefore, it is becoming of critical importance that greater emphasis be placed on the work of internal audit and the AC. It is also expected that council oversight structures in general would derive immediate benefits through a closer

interaction between council and senior management, and internal audit and AC” (Department: National Treasury 2012:1-2). Sepuru’s research aimed to investigate the role of the IAF in assisting management to minimise or reduce the occurrence of service delivery protests and concluded that the IAF has a role to play in minimising service delivery protests by recommending upgrades to weak or inefficient controls (2017:137).

The internal auditing requirements, standards, and methodology applied are similar in both the private and public sector. Of importance is that internal auditing can assist the organisation to mitigate risks that are unique to the public sector ultimately resulting in improved performance of the organisation and increased confidence by the citizens (Janse van Rensburg & Coetzee, 2015:181-182). Barac and Van Staden posit in their research that for the IAF in the public sector to be a credible corporate governance mechanism, some of its dimensions must be similar with those in the private sector (2014:21). They used three dimensions, based on a study by Lenz, Sarens and D’Silva (2014:127), to conceptualise the examination of the IAF to be input, process and output, which is graphically represented below:



Figure 2.1: Three dimensions for the examination of the IAF

(Barac and Van Staden. 2014:22-27)

The capacity of the IAF is especially relevant in the public sector context where internal audit skills are considered scarce (Coetzee *et al.*, 2009:129; Erasmus *et al.*, 2014:6). Mbewu and Barac also elaborated that the IAF resources, processes, relationships, and organisation are the four factors affecting IAF effectiveness (2017:17-20). The importance of reporting lines to ensure appropriate procedures are applied, is emphasised by Coetzee *et al.*, (2009:4), Norman, Rose, and Rose (2010:555) and Erasmus *et al.*, (2014:27). Mihret and Yismaw researched the implementation of recommendations (2007:472) and an investigation on the reliance placed by external audit on the IAF was concluded by Burton, Emmet, Simon and Wood (2012:152). These three dimensions have also been applied in this research.

Section 2.3 above reflects on the value-adding role of internal auditing and that the IAF can play a key role in ensuring the goal of the public sector contained in the Constitution is achieved. Van der Nest, Thornhill, and De Jager also acknowledge that accountability instruments such as the IAF and the ACs play a key role to ensure sound financial management in the public sector (2008:546). To assist internal auditors to fulfil their mandate various requirements and guidelines have been issued over the years. The following section will elaborate on the most important requirements and guidelines relevant for internal auditing in local government.

2.6 LEGISLATIVE AND GUIDELINES REQUIREMENTS

Like any other profession, the IAF must abide by requirements meant to aid them to perform their duties. This section focuses on the legislative requirements, followed by the professional requirements and other guidance.

2.6.1 Legislative requirements for Internal Auditors in local government

The establishment and responsibilities of the public sector IAF in South Africa are documented in the regulatory framework. The regulatory framework comprise of the Constitution of South Africa, Act No 108 of 1996; the Public Finance Management Act No 1 of 1999 as amended by Act 29 of 1999 (PFMA); Treasury Regulations for departments, trading entities, constitutional institutions and public entities issued in terms of the PFMA; and the Municipal Finance Management Act No 56 of 2003 (MFMA). However, the relevant legislation discussed in this study is the Constitution and the MFMA, in conjunction with the Local Government: Municipal Systems Act No 32 of 2000.

Chapter 7, section 152 (b) of the Constitution states that the fundamental goal of local government is to provide sustainable and satisfactory service delivery to all citizens (RSA, 1996:55). The service provision should be “effective, transparent, accountable and coherent” as specified in Chapter 3 section 41 (c) (RSA, 1996:20). To achieve this goal, government needs to set “national, provincial and municipal budgets and budgetary processes that promote transparency, accountability and effective financial management of the economy, debt and the public sector”, as per Chapter 13 section 215 (RSA, 1996:78).

To provide effective management of finances that is transparent and accountable, Chapter 10, sections 195 (1) and (2) require that the basic values and principles in the governance of public administration, including government, organs of state, as well as public enterprises should include amongst others, a high standard of professional ethics; efficient, economic and effective use of resources; accountability and transparency (RSA, 1996:70). To strengthen these values, Chapter 13 section 216 (1) requires the National Treasury to recommend procedures to ensure expenditure control and transparency at all government spheres. The criteria and procedures to be applied include *inter alia* using Generally Recognised Accounting Practices (GRAP) as an accounting framework, applying uniform expenditure classifications, and complying with issued treasury norms and standards (RSA, 1996:78). All these requirements apply to all spheres of government as the Constitution is the ultimate law, however, this research focuses on local government and the requirements specific to this level of government are contained in the MFMA.

Chapters 8 and 14 of the MFMA coupled with Chapter 10 of the Constitution as discussed above regulate the responsibilities of municipal officials and treasury matters. Each municipality must have an IAF that operates within the boundaries of the recommended legislation. This responsibility lies with the accounting officer of the municipality. This is prescribed in sections 62 (1) (ii) and 95 (c) (ii) (RSA, 2003:75; 102). The MFMA further states in section 165(1) that each municipality and municipal entity are obliged to have an IAF, with the responsibilities of the IAF stipulated in section 165(2). It is expected of the IAF to:

- “prepare a risk-based audit plan and an internal audit program for each financial year.
- advise the accounting officer; and
- report to the AC in terms of the IAF’s audit plan and all matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk

management, performance management, loss control, and compliance with the MFMA, the annual Division of Revenue Act (DoRA) and any other applicable legislation” (RSA, 2003:153).

The responsibilities of the IAF are further elaborated on in section 2.6.4.1 as indicated in the Internal Audit Framework. In addition to the responsibilities included in the MFMA, the performance management evaluation processes that contribute to the achievement of organisational goals and the processes used to monitor the achievement thereof are set out. The legislative requirements in the area of performance management are contained in the Local government: Municipal Planning and Performance Management Regulations (RSA, 2001). Regulation 14 requires that the mechanisms, systems and processes for the development and implementation of performance measurement should be part of the internal auditing processes and that the IAF must assess that the municipality has a practical and reliable performance management system in place that is complying with the Local Government: Municipal Systems Act 32 of 2000. In addition, the IAF should continually do audits in this regard and report to the MM and the performance AC quarterly (RSA, 2001:13-14). Having covered the regulatory framework, the next section discusses the professional requirements of the IAF.

2.6.2 Professional requirements

The Institute of Internal Auditors (IIA), in its definition of internal auditing, include references to both the assurance and consulting activities (IIA, 2018:1). The definition of internal auditing was covered in section 2.3 of this thesis. To enable the IAF to provide assurance and consulting services, certain mandatory matters needs to be adhered to. These include the Code of Ethics and the Standards (IIA, 2016:1)

Internal auditors are required to comply with the Code of Ethics that states the values and expectations that govern the conduct of internal auditors. The Code of Ethics is intended to promote an ethical culture within the profession and include the following principles:

- Integrity: internal auditors should act honestly while perform their duties so as to create trust from auditees.
- Objectivity: internal auditors are to exhibit impartiality whilst performing their tasks.
- Confidentiality: internal auditors are expected to treat information with confidentiality, except where they are legally obliged to disclose the information.

- Competency: internal auditors should apply the knowledge, skills and experience needed to perform their tasks (IIA, 2010b:1).

The IIA requires all in the profession to adhere to the International Standards for the Professional Practice of Internal Auditing (Standards) whilst performing their duties. The standards are informed by the Code of Ethics and consist of the attribute standards, performance standards, as well as the implementation standards. The attribute standards address the characteristic that the organisations and internal auditors should possess, whilst the performance standards describe the quality criteria against which the performance of internal auditors can be measured. The implementation standards, on the other hand, develop from both the attribute and performance standards and offer guidance for assurance and consulting services (IIA, 2016:1).

The IIA recognises that entities differ in their environments, both legal and cultural, as well as in their purpose, size, complexity, and structure. The IAF is therefore affected differently in these environments, hence the regulatory body, the IIA, requires all members in the profession to adhere to all standards, namely the attribute as well as performance standards, whilst performing their duties (IIA, 2016:1). Both the attribute standards and performance standards are further discussed in the following two sub-sections.

2.6.2.1 Attribute standards

Attribute standards spell out the mandate, position of the IAF in the organisation, access to information, and the scope of activities to be performed. All of these should be evident in the internal audit charter (IIA, 2016:3). The attribute standards comprise four broad categories as discussed below:

Purpose, authority, and responsibility (1000)

The IAF is managed by the chief audit executive (CAE), who is mandated to prepare the internal audit charter periodically and to present it to the board for approval and the accounting officer for acceptance. In terms of local government, the board will be the AC. The charter outlines the directive of the IAF and serves as the “statement of purpose, authority and responsibility”. It should also include the standards to be complied with, the position of the IAF within the institution, a description of assurance and the nature of consulting activities, the period of review of the charter, the appointment and the dismissal

of the CAE, and access to information, properties and personnel. (Department: National Treasury, 2012:16; IIA-Australia, 2014:4; IIA, 2016:3).

Independence and objectivity (1100)

When performing their duties, the IAF should be independent of the management and the board, and that is achieved by having a functional reporting line to the AC chairperson and an administrative reporting line to management. The internal auditors, on the other hand, should be objective (impartial and not compromise on quality) whilst performing their duties. The independence of the IAF is determined by the organisational and reporting structures, whilst its objectivity is accomplished by an appropriate mind-set. This allows the IAF to evaluate the risks that an organisation is exposed to in terms of organisational governance, operations, as well as information systems. As a result, the IAF is capable of evaluating the efficacy of processes, the truthfulness and dependability of financial and operational information, the preservation of assets, as well as the organisation's ability to conform to laws, regulations and conventions (Cascarino & van Esch, 2007:5; National Treasury, 2012:15-16; IIA-Australia, 2014:4; IIA, 2016:3-5).

Proficiency and due professional care (1200)

Proficiency and due professional care, as part of the attribute standards, refers to the knowledge, abilities, and other qualities that an internal auditor should possess. These include the professional certifications offered by the IIA and other professional organisations. Internal auditors are also expected to continually improve their professional skills (IIA, 2016:6-7). To be appointed as a CAE, the individual would have to possess either of the following qualifications:

- “Postgraduate degree in Auditing and/or Accounting;
- Professional designation such as Certified Internal Auditor or other relevant professional designation;
- Preferably possess at least five years' experience in internal audit management and be a member of the Institute of Internal Auditors” (Department: National Treasury, 2012:15).

Quality assurance and improvement program (1300)

From the definition of internal auditing, it is said that the IAF is an assurance activity, and as a result, it is mandatory to have a quality assurance and improvement program. This program enables the IAF to be evaluated on whether they conform to the standards or not, and that the internal auditors adhere to the code of ethics. This evaluation must be done internally on an on-going basis to ascertain compliance with standards. These assessments can include but are not limited to, auditee feedback surveys and performance evaluations (IIA-Australia, 2014:9; IIA, 2010a; 2016:7-8).

Other self-assessment evaluations that must be done by the IAF or by other persons within the organisation that possess adequate knowledge of internal audit work are known as periodic self-assessments, for example the review of the internal audit charter. As important as internal evaluation is to ascertaining conformance of the IAF to the standards and ethics, the IAF must also be evaluated externally by a qualified independent assessor, at minimum, once in five years. The result of these evaluations must be reported to management and the AC by the CAE. These results should stipulate whether the IAF conforms to the standards or not. Should the results indicate that there is non-conformance, its impact should also be reported (IIA-Australia, 2014:9; IIA, 2010a; 2016:7-9). Having explained how the IAF should be organised, the next section discusses the performance standards.

2.6.2.2 Performance standards

The performance standards refer to the setup within the IAF as well as the criteria upon which the IAF's performance can be evaluated (IIA, 2016:1). The performance standards comprise the following six categories:

Managing the internal audit activity (2000)

The management of the IAF lies with the CAE as the head of the IAF to ensure the function adds value to the organisation. The tasks of the CAE in managing the IAF include the development of policies and procedures to guide the IAF, and a risk-based internal audit plan that incorporates the priority projects of the IAF in line with institutional goals. The risk-based internal audit plan should be reviewed and approved by the governing body and management (IIA, 2016:10-12).

The IAF will be deemed effective when it accomplishes its purpose and responsibilities outlined in the internal audit charter, as well as when individual internal auditors abide by the code of ethics and the standards, and they take cognisance of developments that could impact the organisation whilst performing their duties. The CAE is mandated to provide periodic reports to management and the board. These reports include but is not limited to, the internal audit charter; independence of the IAF; the audit plan, its progress and resource requirements; results of audit activities; conformance with the code of ethics and the standards; action plans to address non-conformance, and management's response to risk (IIA, 2016:11-12).

Nature of work (2100)

The IAF is required to assess and make recommendations for improvement of the institution's governance, risk management and control processes using a systematic, disciplined, and risk-based approach as indicated in the internal audit definition. For governance processes, the assessment and recommendations by the IAF should assist the organisation to make decisions at all levels, administer risk management and control and communicate these at appropriate levels, endorse appropriate beliefs and morals, and synchronize activities between the board, management, external and internal assurance provides (Department: National Treasury, 2012:20; IIA, 2016:12-13).

The assessment of risks and the subsequent recommendations for risk management processes by the IAF should ensure institutional objectives sustain and support the institutional mission; that high-risk areas are predicted and their impact evaluated and suitable responses to mitigate risk are selected; and appropriate risk information is recorded and transferred to management timeously for action (Department: National Treasury, 2012:20-21; IIA, 2016:13).

For control processes, the assessment of and recommendations on controls involve the IAF's evaluation of the appropriateness and effectiveness of controls meant to address risks within an institution's "governance, operations, and information systems". These should result in a compliant institution that achieves its objectives, has reliable financial and operational information, has well-organized operations that are effective, and is preserving its assets (IIA, 2016:14). Thus, the IAF's integrity and impact is greater when they are pre-

emptive, practical, and their assessments produce new solutions that are future-oriented (IIA, 2016:12).

Engagement planning, considerations, and scope (2200)

Each engagement should be planned and documented to include the engagement objectives, scope, timing, and resource allocation. Engagement planning should consider organisational strategies and objectives; engagement risks; appropriateness of governance, risk management and control processes; as well as the opportunities for making substantial enhancements to governance; risk management and control processes (IIA, 2016:14-15).

The engagement scope must be adequate to accomplish the objectives of the engagement; this can extend to perusing systems, archives, employees, and physical possessions. Internal auditors are to establish the suitable resources needed (i.e. skills and competencies) to accomplish the engagement objectives based on the nature and complexity of each engagement, time, and resource constraints. Work programs should also be developed to categorize, investigate, assess, and document evidence during engagement (IIA, 2016:15-16).

Performing the engagement (2300)

It is the responsibility of the CAE to develop policies that are consistent with organisational guidelines on how the engagement records will be handled. This includes the custody, retention, and dissemination of records. This process of performing the engagement includes getting facts using appropriate engagement techniques, supporting observations with relevant information, and making recommendations useful to meet organisational goals. For quality assurance and staff development to prevail, engagements should be properly supervised, and evidence of supervision should be recorded and preserved (IIA, 2016:16-17).

Communicating results (2400)

Material issues of governance, risk management, and control may be identified during engagements and should be communicated to management and the board. Engagement results should be reviewed and approved by the CAE or his/her delegation before

communication with relevant parties. These parties, being audit clients, have the responsibility to deliberate on these results and act. Should these results be released to parties outside the organisation, the CAE should assess the potential risk to the organisation, consult with senior management, or control the dissemination by restricting the use of these results, provided there is no legal, statutory or regulatory mandate. The engagement report should include the scope and its limitations, a reflection of all projects connected to the current engagement, a summary of evidence that supports the audit opinion and criteria used to arrive at the overall opinion, as well as the overall opinion. If the overall opinion is unfavourable, reasons should be provided (IIA, 2016:17-20).

Monitoring progress and communicating the acceptance of risk (2500 & 2600)

The creation and maintenance of a system that monitors the execution of management actions and the acceptance of the risk of not acting by management is the responsibility of the CAE. Upon realisation that management has accepted a level of risk that may be unacceptable to the organisation, the CAE should elevate the matter to senior management and if not resolved at management level, the matter should be elevated to the board (IIA, 2016:20).

The standards spell out how the IAF should be managed and how its performance should be evaluated. The next section focuses on corporate governance requirement for internal auditing in South Africa.

2.6.3 Corporate governance requirements

In South Africa, corporate governance is guided by the various King Reports issued over the last two decades under the chairmanship of the retired Supreme Court Judge Mervin E. King. The Institute of Directors in Southern Africa (IoDSA) commissioned the first King Committee in July 1993 and subsequent to the first issue, three additional corporate governance reports were issued as part of the work done by the King Committee. The King I Report was recognised internationally, when published, as the most comprehensive publication on the subject embracing the inclusive approach to corporate governance that acknowledged organisational stakeholders when developing their strategy (IoDSA, 2002:7-8).

All King Reports (past and present), were and still is non-legislative but co-exists with other laws and regulations in South Africa. The approach recommended was changed from “apply or explain” approach to the “apply and explain” approach where entities are expected to corroborate their claim to being good governance practitioners and demonstrate progress in this regard in their Integrated Reports. The King Report is based on “ethical and effective leadership” and as a result applies to all entities, public and private (IoDSA, 2016:7; 27; 35-37).

Within the South African context, the important role of internal auditing has been recognised and incorporated in the corporate governance requirements from the first King Report through to the King IV Report. In the first King Report, the establishment of an IAF was highly recommended. This recommendation came with the request that the board should ensure that the IAF has a respectable reputation in the organisation. The role and responsibilities of the IAF were adopted from the IIA definition (IoDSA, 1994:21-22).

Despite economic and legislative changes that led to the issue of the King II Report, the requirement of establishing an IAF was still emphasised and additional to the requirements of the King I, the King II report included recommendations that internal audit should follow a risk-based approach in the development of its audit plans and should coordinate their activities with those of external audit and other assurance providers (IoDSA, 2002:90; Carscarino & van Esch, 2007:192).

The King III Report issued in 2009, continued to emphasise the need for internal auditing by suggesting that it should be an effective risk-based IAF that abide by the IIA Standards and code of ethics and the mandate in the approved internal audit charter. Compared to the compliance-based internal audit that focuses only on evaluating compliance with legislation, procedures and processes, a risk-based internal audit allows the IAF to assess the effectiveness of controls in mitigating the risks that will prevent the organisation from achieving its objectives. It is thus expected of the IAF to evaluate organisational governance processes, the effectiveness of risk management and internal controls (IoDSA, 2009a:15, 31, 95).

According to the King III, the IAF should be strategically positioned to be able to achieve its objectives. This requirement alludes to the independence and objectivity of the IAF achieved by functionally reporting to the AC who are responsible for oversight, and administratively to

management. Being strategically positioned will permit the IAF to attend to strategic, operational, financial and sustainability matters in its pursuit of delivering value to the entity, provided that the IAF is skilled and resourced appropriately and that quality assurance and improvement programmes are in place (IoDSA, 2009a:97-98). As a minimum, the IAF is expected to perform the following:

- evaluation of organisational processes, as well as ethics, taking the lead from top management;
- performing independent assessments on the adequacy of risk management and internal controls;
- systemic analysis and evaluation of organisational processes and their related controls; and
- inform management about fraud, corruption, unethical behaviour, and irregularities where necessary (IoDSA, 2009a:93; Motubatse, 2014:21-22).

The King IV, issued in 2016, also recognises the IAF as an important role player in corporate governance, and one of the pillars of combined assurance. Not only has the IAF progressed to become a trusted consultant for providing insight to the organisation, but it has also been positioned to provide foresight (IoDSA, 2016:31). Principle 15 of King IV states that the responsibility for assurance services and functions lies with the Municipal Council as the governing body that sets the direction for internal auditing, however, the oversight role should be delegated to an independent AC. It is recommended that the AC should express their view on the effectiveness of the CAE and the internal audit arrangements as part of the AC report. The AC should as part of their responsibilities ensure that the IAF is adequately resourced (skilled staff and budget) or supplemented where necessary. Paramount to this delegated role, the AC should ensure that a competent and objective CAE is appointed and functions independently from management, has the necessary authority and reports functionally to the AC and administratively to management. The termination of employment of the CAE tenure also lies with the AC. Should internal auditing be co-sourced or outsourced, clarity on who fulfils the role of CAE should be provided (IoDSA, 2016:55-56; 68-69).

The AC should approve an internal audit charter that specifies the role, authority, and duties of the IAF, including the IAF's role in combined assurance. The on-going monitoring of the implementation of an approved risk-based internal audit plan as well as regular reviews of

risks and proposed changes to the internal audit plan are essential. The IAF is expected to issue an annual statement on the effectiveness of the organisation's governance, risk management and control processes. An independent quality review of internal auditing is a necessity every five years. This will confirm that the IAF conforms to the industry standards and Code of Ethics (IoDSA, 2016:69).

Besides the legislative, professional, and corporate governance requirements, various other relevant guidance documents have also been issued. The two documents most relevant to this study are the Internal Audit Framework issued by National Treasury and MFMA Circular No. 65. The requirements contained in both these documents and additional guidance documents are discussed in the next section.

2.6.4 Other guidance documents

The principles of public administration contained in the Constitution are embedded in the responsibilities of the IAF in terms of their responsibilities to evaluate controls, risk management and governance processes. All the areas of responsibility as reflected in the various guidance documents are discussed in the following sections.

2.6.4.1 Internal Audit Framework

The Framework is considered the pre-eminent guidance mechanism on internal auditing in the public service in South Africa and aims to provide a standard set of guidelines regarding internal auditing in government. The purpose of the Framework is to ensure that the established IAFs comply with the requirements of the Constitution of the Republic of South Africa, the MFMA, the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing (Standards) and the COSO framework on internal control as well as the risk management framework (Department: National Treasury, 2009:1-2).

The Framework recognises the IAF as one of the most significant management tools that can provide value-added services when it is objective and adequately resourced. The IAF must be well planned, organised, staffed, trained, directed, and monitored to enable the provision of value-adding services. The Framework provides guidance on the establishment of the IAF; its organisation; its development of the Internal Audit Strategic and Operational Plan; staffing the IAF and the quality assurance and improvement program of the work to be performed (Department: National Treasury, 2009:25-43).

The IAF must provide management with assurance on the effectiveness of the system of internal control, risk management and governance processes. These are further elaborated on below:

2.6.4.1.1 Governance processes

The role of the IAF in the governance processes is described in the Framework as follows: “to assist the organisation in achieving its goals, creating, and maintaining particular values. It does so through the appropriate accountability and by evaluating processes that contribute to the achievement of these goals and values, specifically the communication of the goals and values and the processes used to monitor their respective achievement” (Department: National Treasury, 2009:7).

Strongly related to this is the role of the IAF in the evaluation of the performance management system and non-financial information contained in the requirements of the Local government: Municipal Planning and Performance Management Regulations (RSA, 2001) and the Municipal Performance Regulations for Municipal Managers and Managers Directly Accountable to Municipal Managers (RSA, 2006), discussed in section 2.6.1.

The IoDSA explains that the role of the IAF in governance is to make assessments and recommendations for improvements pertaining to governance processes by establishing goals and values, monitoring their implementation, ensuring accountability of those tasked with a job and to preserve values (IoDSA, 2002:89-90).

2.6.4.1.2 Risk management processes

The role of the IAF in risk management is described in the Framework to assist both management and the AC by examining, evaluating, and reporting on the adequacy and effectiveness of the risk management process (Department: National Treasury, 2009:7). In line with the description of internal audit in section 2.3, the IAF provides consultation and facilitation services to management to help them to identify, evaluate and assess the organisational risks that may hamper the achievement of organisational objectives. However, this does not mean that internal auditors are the custodians of risk management. The framework recognises that risk management is a key responsibility of management and the accounting officer (in the case of municipalities the MM). The IAF has to provide assurance on the sufficiency and effectiveness of the risk management processes within the entity (IoDSA, 2002:89-90).

2.6.4.1.3 Internal control

The IAF also has the mandate to assist management in achieving their objectives and this is achieved by helping management with regards to internal controls. According to the Framework, the IAF should evaluate the existing controls by assessing their adequacy and effectiveness, the change in the likelihood of any risk materialising and develop value-adding recommendations for improvement that will result in the reduction of the likelihood that a risk can materialise (Department: National Treasury, 2009:7).

The framework further provides guidance on the nature of the work that the IAF has to perform, the audit process, as well as the consulting role of the IAF (Department: National Treasury, 2009:45-74). The role and responsibilities of Internal audit as described in the Framework and other sources are reflected upon in section 2.7. The guidance provided by the Framework has been incorporated into the measurement tool on the effectiveness of internal audit at the SBM.

2.6.4.2 MFMA Circular 65

Another important guidance document for internal audit in local government is Circular 65 on Internal Audit and ACs issued by the National Treasury in 2012. The circular provides comprehensive guidance on how to implement and manage the two municipal systems of accountability and governance, namely the IAF and the AC. The purpose of this circular is to assist municipalities to improve the effectiveness of internal audit and ACs, and failure to comply with these legislative requirements would constitute a grave breach of the MFMA (Department: National Treasury, 2012:1).

Similar to the Framework, Circular 65 also elaborates on the independence and objectivity of the CAE and internal audit, the internal audit charter, organising the internal audit activity, developing an internal audit strategic plan, resource requirements and quality assurance and improvements, as well as to provide guidance on the nature of the work that has to be performed by the IAF in the areas of governance, risk management and control, the audit process and the IAF's consulting role (Department: National Treasury, 2012:15-25). The guidance provided by Circular 65 has been incorporated into the measurement tool on the effectiveness of internal audit at the SBM.

2.6.4.3 COSO Framework on internal control

After the release of the Treadway Commission's recommendations in 1992, a private sector initiative was commissioned known as the Committee of Sponsoring Organisation of the Treadway Commission (COSO) to provide principle-based guidance for the design and implementation of effective internal controls. The 1992 COSO Framework is recognised as the leading guide for designing, implementing, and conducting internal control and assessing its effectiveness. In May 2013, COSO published an update to the 1992 Internal Control – Integrated Framework (COSO, 2013).

The updated Internal Control – Integrated Framework addresses the challenges and changes which have emerged to face organisations since the publication of the previous Internal Control – Integrated Framework and guide organisations to develop and maintain internal control systems to achieve the organisation's objectives. This Integrated Framework, like the 1992 COSO framework on internal control, also guides internal auditors when planning the audit engagement. The 2013 Integrated Framework broadened the application of internal control in addressing operations and reporting objectives, and to clarify the requirements for determining what constitutes effective internal control (COSO, 2013). The updated framework retained the core definition of internal control and the five components to be considered when evaluating the effectiveness of internal control.

The Integrated Framework defines internal control as “a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance.” The Integrated Framework provides for three categories of objectives – operations, reporting, and compliance – thus allowing management to attend to different structures of internal control (COSO, 2013:3).

The five interrelated components to be used for the assessment of the effectiveness of internal control indicated in the framework are:

Control environment: Consist of enablers for internal control within the entity. These can include standards, processes and structures put in place to guide the establishment and maintenance of internal controls within an entity.

Risk assessment: Involves the identification and analysis of risks, determining how it should be managed and implementing processes to address the risks that could impact on the achievement of operations, reporting and compliance objectives. This component is a significant part of the work of the IAF and is further elaborated on in section 2.6.4.4 below.

Control activities: Refers to arrangements put in place to ensure management's efforts to minimising the risks of not achieving objectives. Examples include policies on approvals and authorisation, verifications, reconciliations, reviews of business performance.

Information and communication: Refers to management receiving information from and disseminating information to different sources to support the functioning of the internal control environment.

Monitoring activities: This component is about evaluating if the five components of internal control are working effectively (COSO, 2013:4-5).

Various other publications were also issued by COSO to assist organisations. One such publication was the Enterprise Risk Management (ERM) – Integrated Framework issued for the first time in 2004 (Motubatse, 2014:25) and subsequently updated in 2017 (COSO, 2017). The 2017 update was necessary as a result of changes and development in enterprise risk management and the need for organisations to improve the risk management approach due to evolving business environments. The updated document – Enterprise Risk Management – Integrating with Strategy and Performance shows the importance of considering risks during the setting of strategies and in driving performance (COSO, 2017). A Monitoring Guidance, to provide further guidance on the COSO frameworks on internal control and ERM was issued in 2009 (COSO, 2009). The Monitoring Guidance was designed to improve the use of monitoring by helping organisations to maximise effective monitoring and to identify ineffective or inefficient monitoring (COSO, 2009).

In the South African public sector, National Treasury regards the COSO frameworks on internal control and enterprise risk management as international best practices that provide guidance to assist with the improvement of public service institutions' performances on internal control, enterprise risk management and fraud deterrence (Department: National Treasury, 2009:9). The COSO frameworks thus provide internal auditors with guidelines with which to assess the public sector policies, rules, and regulations.

2.6.4.4 Risk management

Assessing the effectiveness of risk management is one of the key elements of the globally accepted definition of internal audit. Internal auditors need to include assessing the addressing of key strategic, operational and compliance risks as part of the annual internal audit plan without compromising their independence by being involved with functions that management is responsible for, such as setting the risk appetite or developing and implementing risk management processes or even making decisions regarding risk responses (Hass *et al.*, 2006:840).

As indicated above, COSO issued an Enterprise Risk Management Framework in 2004, which was revised and issued in 2017. The COSO defined enterprise risk management as the “process, effected by an entity’s board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives” (COSO, 2004:2).

The local government environment in South Africa, in the MFMA (updated 2008), requires the accounting officer (MM) in section 62 (1) (c) (i) to take all reasonable steps to ensure an effective, efficient and transparent system of risk management and internal controls are maintained. In response to the legal requirements, the National Treasury developed a Public Sector Risk Management Framework including guideline documents, templates, and implementation tools (Department: National Treasury, 2010:17).

The specific role of the IAF in risk management is that of “providing an independent, objective assurance on the effectiveness of the Institution’s system of risk management”. Other responsibilities include the provision of recommendations for improvement based on the assessment of effectiveness and to develop the internal audit plan based on the key risk areas (Department: National Treasury, 2010:61).

The Public Sector Risk Management Framework also refers to the Standards, that requires of the IAF to ensure risk management processes are effective by assessing the alignment between the organisation’s objectives and the mission; ensuring that substantial risks are acknowledged and measured; assessing whether risk responses are suitable and can limit risks to a tolerable level; and establishing if relevant risk information is captured and

communicated timeously to enable management and other committees to carry out their responsibilities. National Treasury also recognises that the IAF can assume the role of a risk officer, and therefore provides guidance in this regard. Of importance is that the IAF should under no circumstances accept management responsibilities for risk management (2010:61-62).

2.6.4.5 Public Sector AC Forum Guidance Papers

In 2011, the Public Sector Audit Committee Forum (PSACF) came into existence to facilitate guidance and offer support to members of public sector ACs, focusing on governance and accountability roles thereof. This is a joint effort by the IoDSA, the Institute of Internal Auditors in South Africa (IIASA), the South African Institute of Chartered Accountants (SAICA), the Institute of Risk Management South Africa (IRMSA), National Treasury (NT), the Auditor-General South Africa (AGSA) and the Development Bank of Southern Africa (DBSA) (PSACF, 2019:2).

Some of its objectives include “to provide thought leadership on the function, duties and composition of public sector ACs by discussing, researching, developing and disseminating position papers and good governance guidance; and to support public financial management, governance, risk and control initiatives to improve audit outcomes across all spheres of government” (PSACF, 2019:4).

The position papers related to internal audit issued include:

- Evaluation of the IAF – provides guidance on how the AC should evaluate the effectiveness of the IAF (PSACF, 2015(a): 4-6);
- The role of ACs in relation to the external and internal audit process – guides the AC on the importance of its role in ensuring the delivery of quality audits (from the auditors) and how the implementation of audit responses (by management) should be facilitated (PSACF, 2015(c):3); and
- Public Sector Audit Committee role in overseeing Internal Audit – provides guidance on the minimum oversight and responsibilities of the AC over the IAF (PSACF, 2014(a):4-6).

Having considered the legislative and professional requirements for the IAF as stated above, the next section will elaborate on the roles and responsibilities of the IAF.

2.7 ROLES AND RESPONSIBILITIES OF THE IAF

As a result of their mandate, the IAF is in an ideal position to assist management to monitor high-risk areas, comply with the regulations and to ensure effective financial reporting controls (Hass *et al.*, 2006:837). Dittenhofer recognises that internal audit as part of their role to provide assurance on the adequacy and effectiveness of internal controls, governance and risk management become the sensory apparatus of all levels of management by identifying the causes of problems and making recommendations for improvement (2001:468).

Before the nature of internal audit work is discussed it is considered necessary to reflect on the requirements for the establishment of the IAF, as reflected in various guidance documents. The Internal Audit Framework identifies various important aspects for the successful establishment and continued effective operation of the IAF and include the following steps:



Figure 2.2: Establishment of the IAF

(Department: National Treasury, 2009: 26-44)

Part of the planning of the IAF includes identifying a CAE and compiling an Internal Audit Charter. The appointment of a CAE is identified as an important aspect. According to the Framework the CAE should be appointed at a senior management level and should have the necessary qualifications and a good understanding of risk and management processes and practices (Department: National Treasury, 2009:26).

In line with accepted assurance requirements, the CAE and the internal audit team need to be objective and independent. The objectivity and independence can be secured by the organisational status and structure of the IAF and the reporting line of the CAE. To ensure independence and objectivity, the internal auditors should avoid conflict of interest and also not have any direct operational responsibility or authority over any of the municipality's activities or be involved with the development or installations of procedures that they will audit (Department: National Treasury, 2009:28-29). According to the Internal Audit Framework the CAE must report at a level within the entity that enables the IAF to fulfil its responsibilities and have sufficient authority to ensure actions are taken on recommendations, therefore the CAE must report functionally to the AC and administratively to the Accounting Officer (MM) (Department: National Treasury, 2009:27). King IV also recommends that the CAE position carries the necessary authority (IoDSA, 2016:69). Another determining factor to a successful IAF is support from management, council, and the AC (Department: National Treasury, 2009:28).

The CAE has the responsibility to develop the Internal Audit Charter, a key document in which the roles and responsibilities of the IAF need to be clearly defined. The Standards and the Internal Audit Framework describes the internal audit charter as the written statement of purpose, authority and responsibility of internal audit that addresses the standards to be complied with; the scope of work to be undertaken; the position within the organisation; a description of assurance and nature of consulting services; the period of review of the charter; the appointment and the dismissal of the CAE; and access to information, properties and people. The Internal Audit Charter must be approved by the AC and the accounting officer. Annexure 2 of the Internal Audit Framework provides an example of an Internal Audit Charter (Department: National Treasury, 2009:30).

In terms of organising the IAF, the CAE will take overall responsibility for planning, resource management and ensuring implementation of operating policies and procedures, review of work, coordination of assurance activities and quality assurance (Department: National

Treasury, 2009:31). The coordination of assurance activities is an important part of governance and is further discussed under section 2.7.5, combined assurance.

The next step in the establishment of the IAF is the development of an Internal Audit Strategic Plan. The preparation of such a plan will guide the work to be performed by internal auditors over the medium term. The strategic plan must be risk-based to ensure internal auditors focus on those areas that could impact on the municipality achieving its objectives (Department: National Treasury, 2009:32-35). Developing a strategic audit plan follows a logical process as displayed below:



Figure 2.3: Steps in the development of the Internal Audit Strategic Plan

(Department: National Treasury, 2009: 32-34)

Following the strategic audit plan, an annual operational plan must be prepared based on an assessment of risk exposures that can affect current strategies and direction of the Municipality. The overall responsibility to ensure that strategic and operational plans are developed annually, approved by the AC, and accepted by the MM lies with the CAE. In developing the operational plan cognisance must be taken of the availability (capacity) and skills of the internal audit staff; changes in key risks, changing priorities and emerging audit needs. Any changes to the operational plan must be approved by the AC. It is the responsibility of the MM and the AC to ensure that the IAF is adequately resourced for effective functioning (Department: National Treasury, 2009:35-37).

The internal audit structure should be developed taking into consideration the municipality's needs, including risk and complexity of the operations. The structure should be developed to include the necessary levels of supervision and review of audit work in line with due professional care and in accordance with the requirements of the Standards. According to

the Internal Audit Framework, the internal audit staff at all levels should have well-documented job descriptions, clear goal setting, performance evaluations, and attend the necessary training programmes (Department: National Treasury, 2009:39-40).

The last but especially important activity is to ensure a properly designed and implemented quality assurance and improvement program. The activities of the internal auditor must be guided, monitored, and supervised at each level of operation to ensure compliance with the Standards. More than the supervision on individual assignments, the Internal Audit Framework also refers to internal assessments and external assessments that need to be performed. Internal assessments should ideally be conducted by senior officials who are experienced in the internal audit discipline. Internal assessments would evaluate compliance with the Internal Audit Charter, Internal Audit methodology and compliance with the Standards. External Assessments must be completed at least once every five years by a qualified external reviewer or review team and the results should be communicated to the AC and the MM. Based on the results of the review, the IAF should prepare an action plan to respond to comments and recommendations contained in the report by the external reviewer (Department: National Treasury, 2009:41-43; IIA, 2010a).

The responsibilities of the IAF have been studied by researchers including Diamond, 2002:23; Malan, 1991:90; Sawyer *et al.*, 2003; Stačiokas & Rupšys, 2005:22; van Gansberghe, 2005:72. The researchers have identified the main areas of responsibility to include:

- reviewing compliance with laws, regulations and procedures;
- evaluating internal controls;
- assessing operational effectiveness, reviewing the integrity of financial information; reviewing budgetary control;
- assessing the safeguarding of assets; investigating irregularities and fraud; facilitating self-assessment;
- assessing business risks; evaluating governance processes and advising on resource utilisation, recommending business improvements.

Therefore, IAF should perform activities related to risk management, fraud detection and prevention, and governance-related matters. The various roles and responsibilities in these areas of responsibility are further discussed in the sections below.

2.7.1 Risk management

Section 165 (2) (b) (iv) of the MFMA and the Standards, Performance standard 2110 are the legislative instruments that provide the legal foundation for IAF's responsibility for risk management. Sections 62 (1) (c) (i) and 95 (c) (i) of the MFMA, require of the Accounting Officers to ensure that their municipalities and municipal entities have and maintains an effective, efficient, and transparent systems of risk management. Section 165 (2) (b) (iv) requires of the IAF to advise the accounting officer and to report to the AC on the implementation of the internal audit plan and matters relating to risk and risk management (RSA, 2003:74; 155).

Various research projects on internal audit and risk management have been conducted. Spira and Page researched risk management and its impact on internal control and the changing role of internal audit. They state that risks are managed within the corporate governance framework by using various accountability mechanisms including financial reporting, internal control, and audit (2003:641). Stačiokas and Rupšys identified seven interrelated components of enterprise risk management to include: environment, event identification, risk assessment, response, control activities, information, and communication and monitoring. During internal audit engagements, internal auditors assess if controls are effective and adequate in the mitigation of risks and make recommendations for the improvement of internal controls (2005:23).

Asare identified fraud and corruption as key risks in the public sector and refers to the role of internal audit to gather sufficient information to enable management to carry out their responsibilities relating to risks. Furthermore, the IAF should be well-informed of fraud risks and the effectiveness of fraud control procedures (2009:23). The Public Sector Risk Management Framework in South Africa also requires organisations through the risk management process to prevent fraud and corruption and provide for this as a focus area in the risk management strategy (Department: National Treasury, 2010:18-20, 24). Although risk management is a key responsibility of the accounting officer (MM), management and the AC, internal auditors' role in this task is to assist management and the AC by conducting appraisals and reporting on the acceptability and usefulness of the risk management process (Department: National Treasury, 2009:7, 45). Coetzee (2016: 359) is in agreement that the IAF has a noticeable role in risk management, but however emphasises that

different stakeholder (CAEs, AC chairs and management) had different views on the impact of this contribution.

National Treasury developed the Public Sector Risk Management Framework including guideline documents, templates, and implementation tools for the Public Service. Chapter 18 of the Risk Management Framework focuses on the functions of internal audit related to risk management. These functions include the:

- provision of unbiased assurance that the system of risk management is effective;
- assessment of the practicality of the risk management system and to make recommendations for improvement where necessary; and
- compilation of the internal audit plan based on the crucial risk areas (Department: National Treasury, 2010:61).

These functions go together with the requirements placed on internal auditors by the Standards that requires of the IAF to determine if risk management processes are effective based on the assessment that:

- “Institutional objectives support and are aligned with the mission;
- significant risks are identified and assessed;
- risk responses are appropriate to limit risk to an acceptable level; and
- relevant risk information is captured and communicated in a timely manner to enable the Accounting Officer / Authority, Management, the Risk Management Committee, and other officials to carry out their responsibilities” (Department: National Treasury, 2010:61-62).

Specific guidelines for internal audit related to risk management is provided as part of the guidance on risk management. In section five the strategic value of internal audit in risk management is described as: “Internal Auditing is accountable to the Accounting Authority/Officer for providing independent, objective assurance on the effectiveness of the Institution’s system of risk management. Hence, Internal Auditing should evaluate the effectiveness of the entire system of risk management and provide recommendations for improvement where necessary”. Although it is not advisable for the IAF to be in direct control of the risk management function, the IAF may be requested to provide advisory and consulting engagements on risk management provided they comply with performance

standard 2110 and they do not assume management responsibility towards risk management but rather provide advice or challenge management decisions (Department: National Treasury, n.d.:1; 2009: 71-72; 2010:62).

Other responsibilities of the IAF in risk management include providing assurance that organisational risk management culture is appropriate, the risk register is a proper reflection of the organisation; how risk management is carried out and benefits the organisation; and that the risk management strategy, implementation plan, and fraud prevention plan are effectively implemented. These responsibilities should be included in the Internal Audit Charter to be approved by the AC and form part of internal audit evaluation, especially the timeliness and quality of assurance on risk management, recommendations for risk management improvements, and the adoption of risk-based auditing. The IAF should therefore make practical cost-effective recommendations to management but should refrain from taking on management responsibility when assisting management in improving the risk management processes (Department: National Treasury, n.d.:1; 2009:7; 2010:62).

Despite the various requirements for internal audit to scrutinise, appraise, and report on the risk management process, a 2017 survey by the KPMG AC Institute found that 82 percent of the AC members believe internal audit's role/responsibilities should include more than the adequacy of financial reporting and controls but also include assessing other major risks and challenges facing the company. According to the survey only half of the AC members surveyed believed their own IAF had the skills and resources to be effective in their envisaged role of moving beyond financial controls only (IIA, 2018:3).

2.7.2 Internal controls

The result of the risk assessment informs the work internal audit will conduct to evaluate the adequacy and effectiveness of controls in the areas of governance, operations, and information systems. The requirements for an effective control framework are prescribed by COSO (see section 2.6.4.3) and it is expected of internal audit staff to have good working knowledge on the framework to be able to apply it in the assessment of internal controls of the organisation.

Internal controls include a combination of policies and procedures designed and approved by management to achieve organisational goals and is said to involve employees. Internal controls are meant to provide acceptable level of assurance that management goals will be

achieved (Jackson & Stent, 2010:5/3). Internal controls ensure that financial and operational information is reliable, operations are conducted efficiently and effectively, assets are safeguarded, and there is compliance with laws and regulations (Department: National Treasury, 2009:49).

Fadzil, Haron and Jantan conducted a study on listed Malaysian companies to determine compliance with Standards and to determine if the compliance result will affect the quality of the internal control system. It was found that the management of the internal audit department, professional proficiency, objectivity, and review significantly influence the monitoring aspect of the internal control system. It was further found that the scope of work and performance of audit work significantly influence the information and communication aspect of the control system, and that performance of audit work and audit reporting significantly influences the control activities as part of the internal control system (2005:844).

In South Africa, one of a few studies on public sector internal auditing was completed by Fourie, who concluded that internal auditing contributes towards sound financial control measures that should enhance good public sector governance (2007:742). Hass *et al.*, recognise the need for different types of internal audit as a result of changes in legislation and technology including the need for more effective documented systems of internal control over financial reporting. They acknowledge that the IAF is in an ideal position to help management comply with the extensive regulations and in many instances are requested by companies to document and test key controls over financial reporting (Hass *et al.*, 2006:837). The IAF, through the development and testing of internal controls and assuring compliance with regulatory and financial reporting requirements, contributes to external auditors and management having a better understanding of the high-risk areas to focus on. The IAF's key role includes ensuring organisational compliance with laws and regulations, the effectiveness of the internal controls, risk management and governance processes in public sector organisations (Motubatse, 2014:15).

Public sector internal control includes all the policies and procedures to promote accountability of resources and are mainly focused on the public financial system. Internal auditing needs to support the monitoring and oversight by management, the governing body, and external auditors over the system of internal controls by providing independent and objective assurance over strategic and operational areas of governance (Montondon 1995:59; Asare 2009:20-21). Asare (2009:21), by referring to Baltaci and Yilmaz (2006:11),

depicts the different areas within the financial management cycle that internal auditing should cover in Figure 2.4 below.

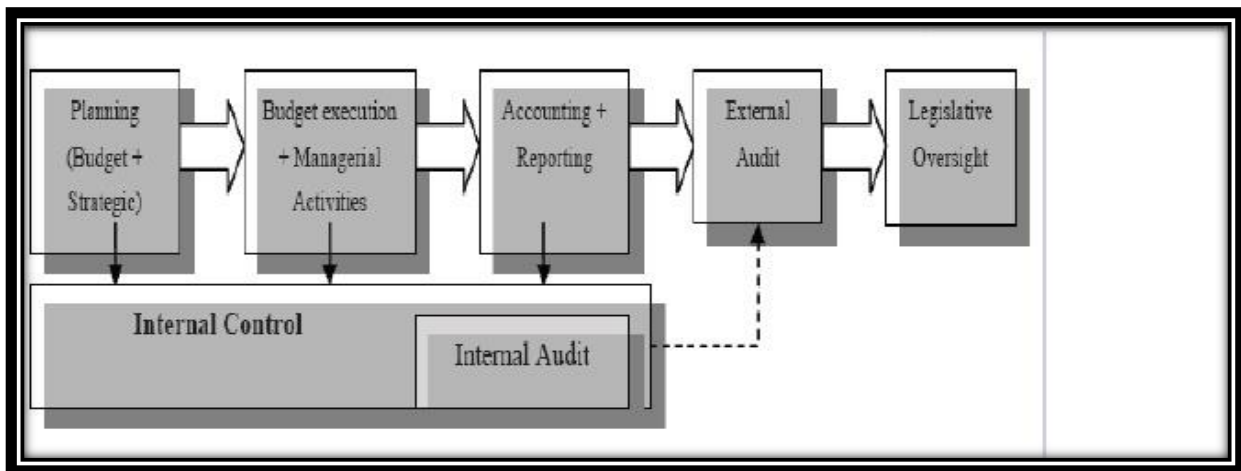


Figure 2.4: Public Financial Management Cycle

(Baltaci & Yilmaz, 2006:11)

The King IV also includes a specific supplement for local government giving the responsibility to Council in principle 15 to ensure that assurance services and functions enable an effective control environment that will support the integrity of information for internal decision-making and external reports of the municipality. The IAF plays a crucial role to assist the Council to fulfil its function. The Internal Audit Framework also recognise that management is responsible for the operation of the internal control systems. The scope of internal controls covers both the financial as well as operational matters. The role of internal auditing in this regard is to evaluate that the internal controls in place are effective and adequate, and whether any of the risks will materialise and to provide recommendations for improvement. The recommendations should always add value in line with the IIA's definition of internal audit. After assessment of the internal control process and the internal controls, the CAE is required to communicate the overall opinion on a timely basis as internal controls form a critical part of governance of any organisation (Department: National Treasury, 2009:8; 49).

Gabrini (2013:13) examined the extent to which a municipal government's internal audit influences its system of internal control and found no practical effect, but rather the existence of the IAF is subjective and satisfies stakeholder expectations and the need to avert certain behaviours that could be detrimental to the organisation (2013:96). In South Africa, however, as a result of the requirement for external audit to express an opinion on non-financial

performance information, the IAF is also responsible to assess controls and make recommendations on the systems generating the performance information.

2.7.3 Governance processes

The Chartered Institute of Public Finance and Accountancy (CIPFA) and the International Federation of Accountants (IFAC) jointly developed an International Framework on Good Governance in the Public Sector. The definition for governance in the public sector adopted in the International Framework on Governance states that “governance comprises the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved” (CIPFA & IFAC 2014:8). The International Framework on Governance identified the following eight principles for good governance in the public sector:

- i. “Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law.
- ii. Ensuring openness and comprehensive stakeholder engagement.
- iii. Defining outcomes in terms of sustainable economic, social, and environmental benefits.
- iv. Determining the interventions necessary to optimize the achievement of the intended outcomes.
- v. Developing the entity’s capacity, including the capability of its leadership and the individuals within it.
- vi. Managing risks and performance through robust internal control and strong public financial management.
- vii. Implementing good practices in transparency, reporting, and audit, to deliver effective accountability” (CIPFA & IFAC 2014: 10).

The International Framework on Corporate Governance further elaborates on the principles and include implementation tips. Of importance for this research are principles six and seven being to manage risks and performance through strong internal control and public financial management and the implementation of good practices in transparency, reporting, and audit, to deliver effective accountability. The IAF can play an important role in ensuring these principles are applied in the organisation and to make recommendations for improvement where necessary. This has been highlighted in the Internal Audit Framework where the IAF is required to assess governance processes and to make recommendations for

improvement on governance areas such as organisational ethics and values, performance management and risk control communication (Department: National Treasury, 2009:51).

2.7.4 Performance management

In terms of the MFMA section 165 (2) (b) (v) the IAF must advise the accounting officer and report to the AC on the implementation of the internal audit plan and matters relating to performance management (RSA, 2003:152).

The guidance paper on performance management defines performance management as a “strategic approach to management enabling stakeholders at different levels to regularly plan, continuously monitor and periodically measure and review performance of the organisation in terms of indicators and targets for efficiency (inputs), effectiveness (outputs) and impact” (PSACF, 2015b:2). To enable efforts to achieve the legislated requirement of measuring performance in an organisation requires a system to determine how this objective will be achieved. A performance management system is thus defined as a “framework that describes and represents how the entity’s cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players” (PSACF, 2015b:2).

Chapter 6 of the Municipal Systems Act is devoted to performance management (RSA, 2000). Sections 40, 41 and 45 require of municipalities to establish mechanisms to monitor and review its performance management system, stipulates the core components of a performance management system and require that the results of performance measurements be audited by the IAF and the AGSA (RSA, 2000). Section 46 of the Municipal Systems Act requires that a performance report reflecting the performance of the municipality be prepared. The performance report should also reflect a comparison of the performance against targets and the previous year and include measures to improve performance. Section 121 (3) (f) of the MFMA requires that the annual report of a municipality must include an assessment by the municipality’s accounting officer of the municipality’s performance against the measurable performance objectives for revenue collection from each revenue source and each vote in the municipality’s budget for the relevant financial year (RSA, 2000).

The Local Government: Municipal Planning and Performance Management Regulations, in regulation 14 requires that the mechanisms, systems and processes for the development and implementation of performance measurement in the municipality should be part of the internal auditing processes and that the IAF must assess the following:

- i. “The functionality of the municipality's performance management system;
- ii. whether the municipality's performance management system complies with the Local Government: Municipal Systems Act; and
- iii. the extent to which the municipality's performance measurements are reliable in measuring the performance of municipalities on indicators referred to in regulation 9 and 10” (RSA, 2001:13-14).

It is further required of the IAF to audit the performance measurements regularly and report the result of these audits on a quarterly basis to the MM and the performance AC (RSA, 2001).

2.7.5 Combined assurance

One of the models used to prove that an entity is effectively governed is the combined assurance model. Combined assurance is an organisational model designed to ensure that a shared approach is utilised for receiving assurance on key risks (van der Merwe, 2016:1). The combined assurance model demonstrates how assurance activities are co-ordinated to provide assurance to the different stakeholders in the organisation (Roos, 2012:32). In the South African context both the King III and King IV Reports refers to the need for an integrated assurance effort. The model for combined assurance is based on different levels of defence and suggests that for an entity to be effectively governed there should be different lines of defence.

The earlier models of combined assurance recommend three lines of defence. The first line of defence initiates risk and is responsible for managing the risk and ensuring that there are mechanisms in place to mitigate those risks. The second line of defence monitors, reviews, and tests the effectiveness of the control and management of risks in the first line. The third line of defence evaluates and gives an independent opinion on the adequacy and effectiveness of both the first and second lines of defence. The IAF, being in the third line of defence, is a significant element in the assurance structure of an entity that helps to improve

management and accountability of both the financial and non-financial aspects of an organisation (IIA-Australia, 2014:2-3).

The following figure demonstrates the combined assurance within the Local Government context as part of governance:

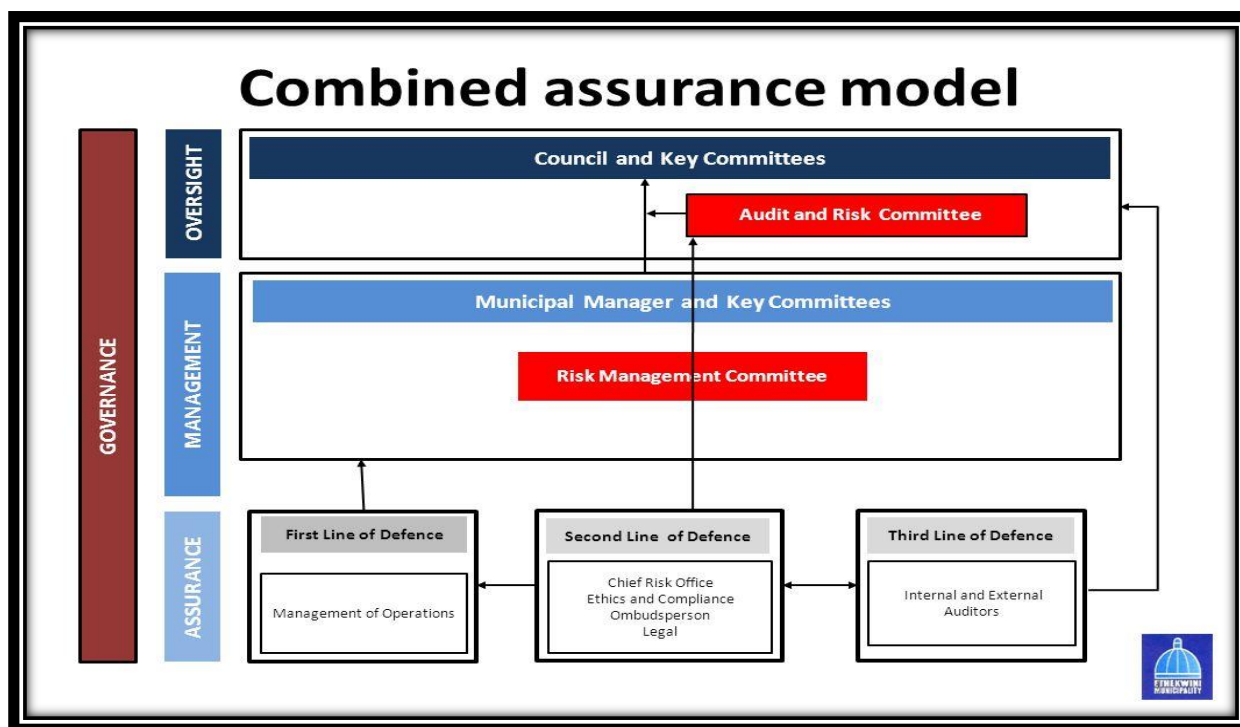


Figure 2.5: Combined Assurance Model

(Mhlongo, 2012)

A strengthened control environment supports the reliability of internal decision-makers on the information provided, as well as the external reports created by the entity (IoDSA, 2016:31). The governing body should assume responsibility for assurance services and arrangements to delegate to the AC. The governing body should further satisfy itself that a combined assurance model is applied, and that the various assurance services and functions are optimised and effectively cover all the significant risks of the organisation. The governing body and its committees should assess the results of combined assurance and form their own opinion on the degree to which an effective control environment has been achieved. The following assurance service providers and functions (also referred to by some as the five lines of assurance) are mentioned in King IV (IoDSA, 2016:68):

Table 2.1: Assurance providers and their functions per King IV

Lines of assurance services and functions	Description
The organisation's line functions	Own and manage risks
Specialists functions	Facilitate and oversee risk management and compliance
Internal auditors, internal forensic fraud examiners and auditors, safety and process assessors and statutory actuaries	Provides independent reviews and gives assurance that systems are effective
Independent external assurance service providers, e.g. external auditors	Provides independent reviews and gives assurance that systems are effective
Other external assurance providers such as sustainability and environmental auditors, external actuaries, external forensic fraud examiners and auditors	Provides independent reviews and gives assurance that systems are effective

(IoDSA, 2016: 68)

Central to the five lines of assurance is the IAF. The IAF needs to provide insight as well as foresight and guide the entity in its corporate governance endeavours. King IV does not prescribe how this should be applied, but rather leaves it to the discretion of the governing body and management (IoDSA, 2016:21, 31).

2.7.6 Internal audit assessments / quality assurance

Standard 1310 require that the CAE prepares a quality assurance and improvement program that include internal and external assessments. Internal assessments (Standard 1311) include routine monitoring and periodic assessments of the IAF by qualified personnel to assess the IAF's adoption of the Code of Ethics and the Standards. External assessments (Standard 1312) must be performed by an independent qualified assessor at least once every five years. The results of the quality assurance are communicated by the CAE to senior management and the Board (Standard 1320), disclosing any non-conformance and its impact (Standard 1322) (IIA, 2010a:1-2; 2016:7-9).

Okibo and Kamau conducted a study to explore internal auditors' compliance with quality assurance standards using a case of state-owned corporations in Kenya. They recognise the importance of a quality assurance and improvement program in that it would assist the IAF to assess the quality of the work done and to ensure continuous improvement by addressing the identified weaknesses (2012:111). Soh and Martinov-Bennie examined the performance evaluation practices of internal auditing in Australia. They found that internal auditing has experienced an expansion and refocus on its role as a result of regulatory changes, increased awareness of the value added by internal audit, cultural shifts, and the increased quality of individuals. However, the performance evaluation mechanisms of the IAF have not evolved in accordance with the expanded roles and responsibilities (2011:618).

Kinsella also identified the benefits of the quality assurance and improvement program to include assisting in the assessment of the purpose, position, process, people, and performance of the IAF. The results of the quality assurance and improvement program could indicate to the IAF their level of performance against international best practices, and peers, and provide an opportunity for development and improvement (2010:10). Compliance with the Code of Ethics and the Standards is a mandatory requirement for all IAFs and the criteria for their evaluation should be based on such compliance (Marais, Burnaby, Hass, Sadler & Fourie, 2009:889). In earlier research, Marais states that although compliance with the Standards is not enforced in South Africa, public sector legislation and regulations have been developed to require the IAF's compliance with the Standards (2004:105).

2.7.7 Internal Audit Charter

The IAF is placed in a position where it gives independent assessments on whether the organisation has an appropriate risk and control environment, and at the same time encourage strong risk and compliance culture within an organisation. The work performed by the IAF should be risk-based and should include all operations of an entity, both financial and non-financial in nature as discussed in 2.7.1 above (IIA-Australia, 2014:2). It is important for stakeholders to understand the roles and responsibilities of the IAF and the one authoritative document that can assist in this regard is the Internal Audit Charter/Terms of Reference. The Internal Audit Charter must clearly define the purpose, authority, duties and range of activities performed by the IAF as it promotes the IAF at all levels of the organisation and can be used as a baseline to measure IAF performance (IoDSA, 2009b:2).

Lenz *et al.*, conducted a study to identify, examine and evaluate the characteristics of an effective IAF through a survey with forty-six heads of internal audit. They used four key dimensions including organisational characteristics, resource characteristics, process characteristics and internal audit relationships. Under organisational characteristics, having a written internal audit charter is a minimum IAF's operational requirement and any IAF without such a charter would warrant an unsatisfactory rating in a quality assessment (2014:127).

The internal audit charter is prepared by the CAE periodically and presented to the board for approval. In terms of local government, the board will be council that delegates the functions relating to internal audit to the AC (IoDSA, 2009b:8; IoDSA, 2016:69). On an annual basis, the AC will assess the effectiveness of the IAF using the following criteria:

- “Achievement of the annual internal audit plan;
- Compliance with the *Standards*, including quality assurance assessments;
- Achievement of reporting protocols through management to the AC;
- Timeliness of reporting of findings and activities;
- Responsiveness to changing operational environment;
- Management's acceptance of internal audit findings;
- Quality and relevance of the annual assessment reports;
- Level of cooperation and interaction with other assurance providers with the agreed combined assurance approach;
- Maintenance of adequate staffing levels to achieve the requirements of the charter; and
- Meeting the budget allocated to internal audit” (IoDSA, 2009b:7-8).

The importance of the roles and responsibilities of the IAF has been highlighted, as well as ways to measure the IAF's compliance. The next topic reflects on the different role players that interact with the IAF.

2.8 DIFFERENT ROLE-PLAYERS AND THEIR INFLUENCE

The IAF plays an important role in the governance structure of an organisation, and communication is central to the IAF relationship with other role players. According to the Internal Audit Framework the CAE, being the head of IAF, should have direct communication

with the relevant role-players including External Audit, the Accounting Officer or Chief Executive Officer, the AC, and/or other governing authorities. Direct communication refers to and can include regularly attending and participating in relevant meetings including the executive management meetings, AC meetings and meetings of other governing authorities responsible for auditing, financial reporting, corporate governance, and control (Department: National Treasury, 2009:27-28). The reason for the CAE to attend these meetings is to gain insight and provide an opportunity to exchange information on the IAF activities, plans and progress. The following sections further describe the activities of the different role-players including that of the CAE in relation to the IAF.

2.8.1 Chief Audit Executive

The CAE plays a critical role and as described in Circular 65, must provide advice, counsel, and opinions on the efficiency and effectiveness of risk management, internal control, governance processes and performance management. In terms of the IAF structure, it is recommended that the CAE should be permanently appointed at a senior manager level, reporting directly to the MM. The individual characteristics required of the CAE include possessing a high level of personal and professional ethics including an understanding of the risk management processes and practices. In terms of qualifications, the CAE should have appropriate qualifications and experience including a post-graduate degree in Auditing and/or Accounting, a professional designation such as a Certified Internal Auditor or other relevant professional designation, with at least five years' experience in internal audit management and be a member of the Institute of Internal Auditors. The independence of the CAE can be enhanced when the AC concurs in the appointment or removal of the CAE (Department: National Treasury, 2012:15).

Van Staden and Steyn researched the profile of a CAE as a driver of internal audit quality. The researchers used responses from the CAEs to construct a profile of the average CAE and based on the current profile, determine the minimum profile requirements for prospective CAEs. The profiles were correlated, together with the CAEs' perceptions of the quality to the IAFs. The results of the study indicate that the average CAE of a larger South African listed company holds a post-graduate academic qualification, obtained professional certification in either external or internal audit, is a member of the Institute of Internal Auditors, has five years of internal auditing experience, has been a CAE for five years and has worked for the current employer for approximately five years. It was further found that the profile of the average CAE is closely related to the minimum profile requirements for

prospective CAEs. The results of the study also indicate the profile of the average CAE is positively related to the perceived internal audit quality (2009:924-925). Coetzee, Fourie, Plant and Barac (2013:57) are in agreement and however highlight that CAE competencies and skills are just as important.

2.8.2 External audit (Auditor-General)

In line with the principles of combined assurance, it is critical for internal audit and external audit to have a close working relationship and identify areas where activities can be coordinated. The value of the coordination between internal and external audit has also been recognised by other researchers. In the research by Gavin, Cooper, Leung, Lander and Reinstein (1995:21), ten positive factors influencing the relationship between external and internal auditors were identified of which the top five include sharing of information and good communication; mutual respect, competence and knowledge; assistance with year-end audit and being responsive and co-operative.

In their study on the contribution of internal audit, Felix, Gramling and Maletta (2001:517) recognise coordination has the potential to maximise the effectiveness and efficiency through the minimisation of duplicate audit efforts. Standard 2050 on coordination and reliance requires the CAE to share information, coordinate activities and consider relying upon the work of other internal and external assurance providers to ensure proper coverage and minimise duplication of efforts (IIA, 2016:25). The CAE should consider the competence, objectivity and due professional care of the assurance providers and have a clear understanding of the objectives and work of other assurance providers. However, where reliance is required, the CAE is still accountable to ensure there is “adequate support for any conclusions and opinions reached by the IAF” (IIA, 2016:25).

A pre-requisite for reliance on the work of internal audit by external audit include internal audit staff that is competent and perform at a high standard (Al-Twaijry, Brierley & Gwilliam, 2004:929-930). Reinstein, Lander and Gavin state that external audit should as a minimum consider the results of prior year audits, evaluate the link between risk assessments and allocation of resources by the IAF and review internal audit reports to determine the scope of activities (1994:30). Standard 2400 – Communicating Results, specifies that the IAF must communicate the engagement’s objectives, scope, and results. Standard 2420 denotes that the quality of communications should be accurate, objective, clear, concise, constructive, complete, and timely (IIA, 2016:18). For external audit to rely on the work of internal audit

they would need to receive sufficient, timely information to enable external auditors to evaluate the nature and extent of work of the IAF on which they may rely.

Krishnamoorthy, in his research on the external auditor's evaluation of the IAF confirm the requirements of ISA 610 stating that the IAF should be evaluated on its objectivity, work performance and competence (2002:95). Morrill and Morrill took a different approach from other studies evaluating competencies, objectivity, and performance to determine the extent of reliance, but they examined the conditions at work prior to the decision by external audit to place reliance (2003:492). In their synthesis on internal auditing literature, Gramling *et al.*, recognise various research studies that focused specifically on the relationship between the IAF and external audit. The review highlighted the contingent and complex nature of the decision to rely on the work of internal audit and the importance of the individual IAF quality factors considered in the decisions taken. Quality factors include competence, objectivity and quality of work performance also being dependent on the client's risk levels (2004:200, 232).

In their research to identify factors impacting on the effectiveness of internal audit services, Mihret and Yismaw identified one such factor as to demonstrate the ability to produce useful findings and recommendations (2007:470). Asare also describes the importance of the professional relationship between external audit and internal audit. Internal auditors should endeavour to create an IAF that is effective enough for external audit to rely on the results of the audits by the IAF. The IAF can also be a source of information to external audit due to the in-depth knowledge of the organisation that the IAF possess. A professional relationship would hold benefits for both parties and contribute to ensuring duplication is minimised and gaps are identified and addressed (2009:25).

Schneider also studied the nature, impact, and facilitation of the reliance on IAF by external audit and identified three ways in which external auditors may rely on internal auditing as part of the company's overall system of internal controls. The reliance includes testing of controls, detail testing by internal audit, or using internal audit for direct assistance. Relying on the work of internal audit can minimise duplication of audit procedures. The IAF also have knowledge about the company's business environment, procedures and policies providing an important source of information to external audit (2009:42-43), indeed, Munro and Stewart (2011:464) also identified that external auditors would rely on the work of IAF based on the IAF's reporting relationship with the AC and the IAF's knowledge of the auditee's

business risk environment, otherwise external auditors would only use the IAF to evaluate controls.

In the South African context, the external audit function is performed by the AGSA in terms of the Public Audit Act, No 25 of 2004 (RSA, 2004). International Standards on Auditing (ISA) 610 provide the standards when external audit use the work of the IAF. For external audit to determine in which areas and to what extent the work of internal audit can be used, ISA 610 contains information on evaluating the IAF and determining the nature and extent of work of the IAF the external auditors can use. When evaluating the IAF, the external auditor needs to evaluate the extent to which the IAF's organisational status and policies and procedures support the objectivity of the internal audit. External audit also needs to evaluate the level of competence of the IAF and whether the function applies a systematic and disciplined approach (ISA 610 par 13). In determining the nature and extent of work of the IAF that can be used, the external auditors should consider the nature and scope of the work that has been performed and the relevance to the external audit strategy and audit plan (International Auditing & Assurance Standards Board, 2013).

In the Framework, National Treasury addresses the relationship between the AGSA and the IAF. According to the Framework the IAF should share information and co-ordinate its activities with those of internal and external assurance providers of assurance and consulting services. The Internal Audit Framework encourages internal and external audit to provide access to each other's audit plans and programs, as well as audit reports. It is further recommended that periodic meetings be held between the IAF and external audit. Typical discussion points at these meetings should include access to documents, methodology, key risks, audit scopes, priorities, and findings. Due to their knowledge of the entity the IAF can assist external auditors to obtain an in-depth level of understanding of the business (Department: National Treasury, 2009:43-44).

The importance of the IAF's strategic positioning and co-ordination with external audit is also included in the principles of the various King Reports (also discussed in section 2.7.3). The King II report recommended that the IAF should coordinate their activities with those of external audit and other assurance providers (IoDSA, 2002:90; Carscarino & van Esch, 2007:193). King III continued to emphasise the need for the IAF and that it should be strategically positioned to be able to achieve its objectives (IoDSA, 2009a:46).

In earlier research within the South African context, Fourie highlights the shortcomings in communication skills of internal auditors that might negatively impact the extent to which external auditors' place reliance on the work of the IAF (2008:67). Communication and the need for the IAF to communicate adequately is further discussed in section 2.9. In his thesis, Motubatse refers to the criteria issued by Protiviti that external audit can use to evaluate the IAF including the organisational status of IAF and the accessibility to those charged with governance; appropriateness of professional qualifications and experience relating to IAF including continuing professional education and the quality of working papers, reports, and recommendations (2014:75-76).

Within combined assurance discussed under section 2.7.5, internal, and external audit are some of the key assurance providers and adequate communication and co-ordination is necessary to ensure that the combined assurance approach is effectively implemented. One of the areas in local government in which the co-ordination of activities of external audit and the IAF can be greatly beneficial is in the area of the audit of performance information. The AGSA is required in terms of section 20 (2) (c) of the Public Audit Act, 2004 to audit the performance information reported against pre-determined objectives (RSA, 2004) and the IAF must regularly audit the practicality of the performance management system in terms of Regulation 14 of the Municipal Planning and Performance Management Regulations (RSA, 2001:14). With adequate communication and coordination, the audit of non-financial information can be shared between these two role-players.

2.8.3 Audit Committee

ACs represents the council on oversight matters related to the monitoring of management, the external auditor and the IAF to protect stakeholders' interests. In terms of governance principles in South Africa, principle 15 of King IV recommends that the AC should express their view on the effectiveness of the CAE and the internal audit arrangements as part of the AC report. As part of their responsibilities, the AC should ensure that the IAF is adequately resourced (skilled staff and budget) or supplemented where necessary and that a competent and objective CAE that functions independently from management is appointed and has the necessary authority. The CAE should report functionally to the AC and administratively to management. The termination of employment of the CAE's tenure also lies with the AC (IoDSA, 2016:55-56; 68-69).

The importance of a strong working relationship and the need for interactions between the IAF and the AC has been studied by various researchers some of which is discussed in this section. Related to local government, Davies researched the relationship between ACs and internal audit in Welsh local government. The research surveyed the perceptions of the CAE on the issues affecting the working relationship between the AC and the IAF. The results found that the working relationship between the AC and IAF will depend on individual personalities, authority, governance processes and the preparedness by all parties involved in adopting the published guidance on AC roles and responsibilities. The results also showed that communication between the AC members and the CAE is essential for any working relationship (Davies, 2009:43; 60).

Other studies also focussed on factors that impact the interaction between ACs and the IAF. Scarbrough, Rama and Raghunandan conducted a survey with CAEs of Canadian manufacturing companies and found that where all AC members were independent they had more frequent meetings with the CAE and were more likely to review the internal audit programme and results of internal auditing (1998:51). Similar results were found in the research by Goodwin and Yeo who studied the relationship between AC and internal audit in Singapore and found that more frequent meetings were held with internal audit and private meetings with the CAE where the AC consisted of independent members (2001:122).

Raghunandan, Read and Rama also conducted a survey of chief internal auditors in the United States but not only linked independence of ACs with interaction with internal audit but also the accounting or finance expertise of the AC. They found ACs that were independent and had a member with accounting or finance expertise had longer meetings and more private meetings with the CAE and was also likely to review internal audit proposals and results of internal auditing (2001:105). The reason for private meetings with the CAE or the internal audit team is important to strengthen the independence of the IAF, thus enabling frank and open discussions between the AC and the IAF (Goodwin & Yeo, 2001:122).

A later study by Sarens, Christopher and Zaman focussed specifically on the informal interactions between ACs and internal auditors in Australia examining the importance, nature, and factors associated with informal interactions. They found evidence of the increasing importance of informal interactions between the CAE and the AC was relatively often, mostly by way of email and telephone or in the CAE's office. An interesting finding is

that in more than three quarters of the cases, not all the issues discussed informally were also discussed during formal AC meetings. The researchers found that the factors positively associated with informal interactions include the ability of the IAF to complete a large portion of the audit plan and a highly respected CAE (2013:321).

However, some studies found shortcomings in the interactions between ACs and the IAF. Through surveys and interviews of CAEs and members of the AC, Kalbers reported that although ACs are perceived as active and effective, the reporting problems to the AC could have negative consequences (1992:38). Some of the CAEs stated that they were reluctant to report problems to the AC as it could harm their career progression (1992:41). One of the concerns raised as part of the research is the absence of regular private meetings between the AC and the CAE (1992:42).

One of the key areas of responsibility of the AC is to oversee the work of internal audit (Braiotta, 2004). An effective AC can assist the IAF by providing an independent forum for the IAF to raise any matters affecting management (Goodwin & Yeo, 2001:122). At the same time, the IAF can also assist the AC with their oversight of reporting, risk management and control (Bishop, Hermanson, Lapides & Rittenberg, 2000:50). Of value to the AC is the IAF being a source of information where the AC lacks organisational information as a result of the reduced access to information compared to that of internal auditors (Sarens & De Beelde, 2006a:18). The research by Sarens *et al.*, found that the detailed knowledge of the organisation, involvement by the IAF in improving internal controls, IAF knowledge on risk management and internal controls provided a major source of comfort to the AC (2009:91). The Internal Audit Framework also recognises that the IAF is ideally positioned to act as information source for the AC in its oversight of the system of internal control, risk management, and governance (Department: National Treasury, 2009:12-15).

Having recognised the importance of the mutual beneficial relationship between the AC and the IAF, the IIA issued a best practice and higher standards document. The critical role ACs and management play to elevate and empower the IAF is emphasised in this document by suggesting a ten-point checklist for the AC to use in its oversight role of the IAF (IIA, n.d.:3). The specific responsibilities of the AC oversight on the IAF include the assessment of the performance, the appointment of the CAE, and to support and promote the IAF within the organisation (Davies, 2009:41). Braiotta reflects on vital checkpoints for the AC in the monitoring of internal audit that includes *inter alia* assisting in the development and approval

of internal audit policies to ensure internal audit staff has the necessary authority; providing assurance to the CAE of the AC's support; providing for open communication and obtaining assurance that the internal audit staff is receiving proper cooperation from management (2004:282-283; 288-289).

The South African studies on the relationship between the IAF and ACs relevant to this study were completed by van der Nest (2005) and Motubatse (2014), respectively. Van der Nest examined the support the AC provided to the IAF. The results showed shortcomings in the communication between the CAE and the accounting officers, indicating a lack of support by the AC to ensure the necessary budget and resources are allocated to the IAF (van der Nest, 2005:76). This study recommended that formal interactions include the CAE providing quarterly feedback on progress with the implementation of the approved internal audit plan, and explanations of any deviations (2005:80). In his research, Motubatse focused on the customers' perceptions of the work performed by the IAF in the public sector using the National Treasury as a case study. The study regards the AC as one of the key customers of the IAF. All key customers were of the view that the IAF was fulfilling its role of giving advice and rendering assurance services in the National Treasury, however, there was still room for improvement (Motubatse, 2014:4; 164-165).

As indicated in section 2.6.3, the AC should approve the internal audit charter and monitor the implementation of an approved risk-based internal audit plan. This study also examines the oversight role of the AC and their involvement in the appointment of the CAE as part of the IAF structure. The AC and management play a critical role to support and empower the IAF. The next section explores the role and interaction between senior management and the IAF.

2.8.4 Senior management

Similar to the importance of the working relationship between the AC and the IAF is the relationship between the IAF and senior management. In the guidance paper on the relationship between the AC and management in local government the term management is explained. According to the guidance paper, the Municipal Council appoints a MM mandated to implement policies of council as per the Municipal Structures Act. The MM thus fulfils the role of a chief executive officer. Senior managers are appointed by the municipal council after consultation with the MM and could include executive managers and executive directors (PSACF, 2014(b):3).

The IAF assist management with the design and implementation of effective internal controls by evaluating the internal controls and information systems generating financial and performance information to ensure reliable information is reported. Furthermore, the IAF assist management to improve the effectiveness and efficiency of operations; safeguarding of assets; governance, risk management and compliance with laws by making recommendations for improvement (Sawyer, *et al.*, 2003:64; National Treasury, 2009:46-47). In line with the requirements of Standard 2060, through periodic reporting by the CAE, the IAF can bring significant risk and control issues including findings on governance and other matters to the attention of management and the board for corrective action to be taken (IIA, 2016:11-12). Management also plays a key role in supporting and promoting the work of the IAF within the organisation. It is within this framework of mutual support that the relationship between the IAF and senior management is studied as part of this study.

The study by Lenz, Sarens and Hoos (2017) examined the relationship between the CAE and senior management and the link with internal audit effectiveness focussing on Germany. Sarens and De Beelde (2006b) also studied the relationship between the two parties in Belgium. Lenz *et al.*, used a multiple case study approach for their research and conducted unstructured interviews with the CAE and senior management (2017:4). The results of the study showed that the pattern of interaction between the CAE and senior management is a key determinant of internal audit effectiveness. However, the effectiveness is determined by soft factors such as interpersonal interactions. The more effective organisations had regular, frequent, and timely interaction with the CAE, and the communication was focussed on problem-solving. For the less effective organisations it was found that interactions between the CAE and senior management were also ineffective, being less frequent and creating a larger expectation gap between the parties. The results also showed that meeting expectations can be a misleading concept because expectations in practice vary widely and may demand little of the IAF. The study further found that the CAE adapts to expectations that can work positively or negatively, and further suggests that the CAE can also drive the agenda that can elevate internal audit to a higher level. The researchers also state there might be a link between personality factors and internal audit effectiveness, but further research should be conducted (2017: 11-13).

Sarens and De Beelde qualitatively assessed the relationship between internal audit and senior management by analysing the expectations and perceptions of both parties. The researchers found that most senior management expectations are being met by the IAF.

Similar to Lenz *et al.*, (2017), Sarens and De Beelde found management's expectations have a significant influence on internal audit. Expectations by senior management included the support the IAF provides in the monitoring and improvement of risk management and internal control and suggest internal auditing should be involved in the monitoring of the corporate culture as well. The IAF, on the other hand, seeks management support to assist and contribute towards the overall organisational acceptance of the IAF (Sarens & De Beelde, 2006b:219).

The importance of the relationship between internal auditing and management in the public sector was also highlighted during a forum of interested role-players. Management and internal audit participants identified the following in terms of an organisation and governance framework:

- IAF needs to understand the daily challenges faced by management and structure their work accordingly to be able to respond to management needs. Performing ad hoc assignments was identified as one way of staying relevant to management.
- IAF should also pro-actively communicate with management and follow events in the organisation and be in a continuous dialogue with management (van Gansberghe, 2005:72)

The following figure demonstrates the relationship between senior management and the IAF.

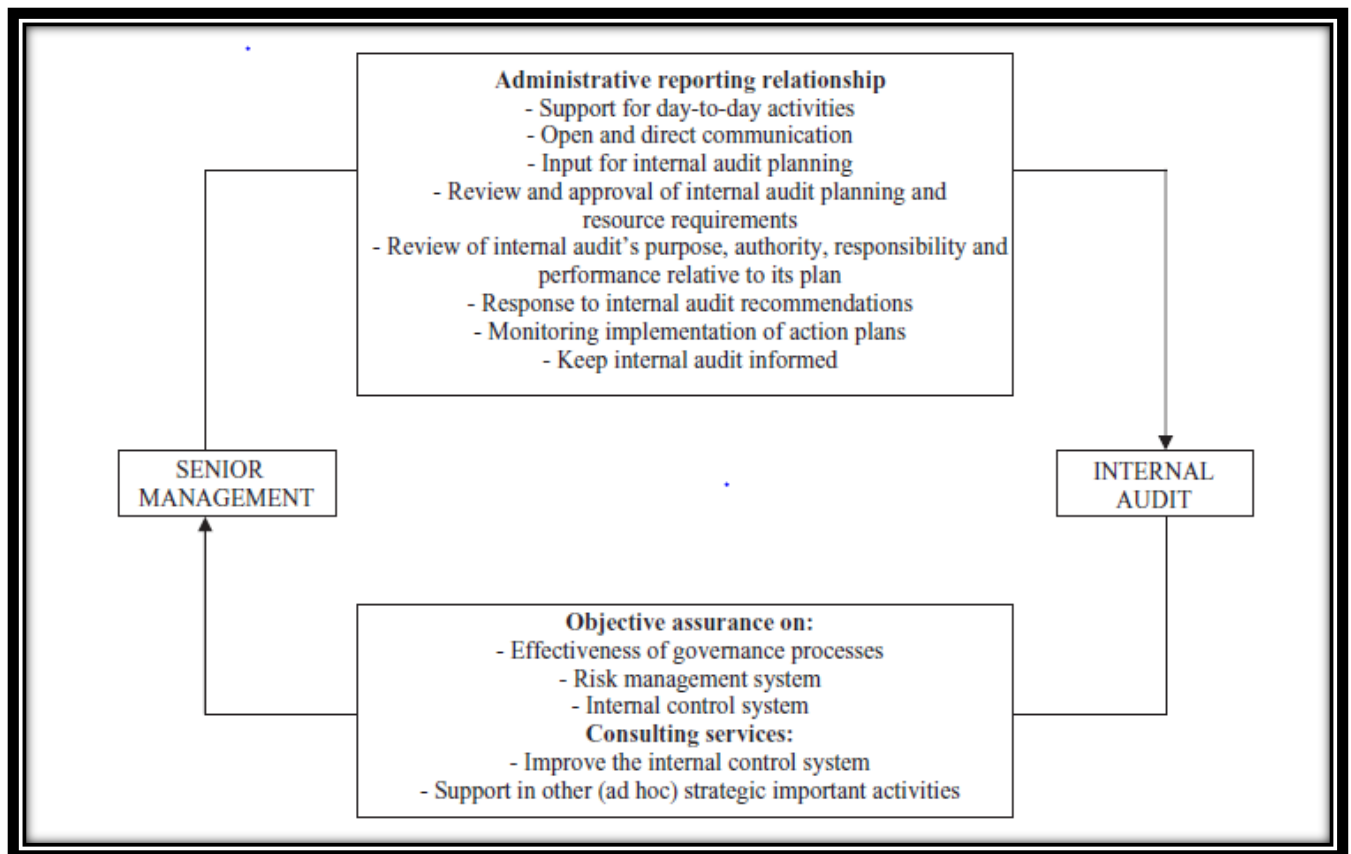


Figure 2.6: Relationship between the IAF and senior management

(Sarens and De Beelde, 2006b: 224)

Motubatse's research on internal auditing include the criteria needed to ensure that the IAF provides value to senior management. This includes to regularly align and adapt the activities of the IAF to the business and changes in the business environment, the needs of senior management; effectively consult and provide advice on an ongoing basis including on emerging governance, risks and control issues and deliver what they promised. The research supports the notion that the IAFs in public service institutions are responsible for providing advice, making recommendations, and rendering a professional service to senior management (Motubatse, 2014:48).

This section supports the view that the expectations of managers include receiving assistance from the IAF to improve governance, risk management and internal control systems within the organisation. At the same time management needs to support and promote the work of the IAF. In this framework of mutual support, the organisation will greatly benefit from improved systems and procedures.

2.9 CHARACTERISTICS AND COMPETENCY REQUIREMENTS FOR INTERNAL AUDITORS

Like any profession, internal auditors need to have the necessary competencies and show certain characteristics to fulfil their mandate. By adhering to the Code of Ethics and the Standards, internal auditors can ensure professionalism. Various literature, discussed below, provide further guidance in this regard.

The professional bearing of internal auditors is guided by the Code of Ethics and the Standards. The Code of Ethics states the principles and expectations governing the behaviour of individuals and organisations while conducting internal audits and describe the minimum requirements for conduct, and behavioural expectations instead of specific activities. The Code of Ethics includes two important sections, namely the principles applicable to the profession and practice of internal auditing, and the rules of conduct articulating the expected behavioural standards internal auditors must comply with as discussed in section 2.6.2 above. The purpose of the rules of conduct is to assist internal auditors with the interpretation and practical applications of the principles and to guide the ethical conduct of internal auditors (IIA, 2013:1). Ethical principles are therefore important for internal auditors because they are frequently faced with ethical dilemmas that can challenge compliance with standards (Larkin, 2000; Goodwin & Yeo, 2001; Thompson, 2003).

A key requirement for any assurance function is objectivity. According to the Code of Ethics internal auditors must demonstrate the maximum professional objectivity while collecting, assessing, and sharing information about any area they are auditing. Any personal interest or interest by others should not influence the auditors' judgements (IIA, 2013:2). Therefore, independence and objectivity relate to being afforded an autonomous position to enable the presentation of findings and recommendations without any influence on the scope restrictions or conflict of interest (Hass *et al.*, 2006:841; National Treasury, 2009:29).

Regarding confidentiality, internal auditors must not disclose information they obtain while conducting their work without the appropriate authority unless there is a legal or professional obligation to do so. The competency principle requires of internal auditors to apply the knowledge, skills, and experience needed whilst performing internal audit services. Thus, it is required of internal auditors to engage only in the activities that they are knowledgeable

about and have the necessary expertise to tackle. Where this expertise is seen to be lagging, it should be supplemented by continuous up-skilling, being effective, and rendering quality services to auditees (IIA, 2013:2-3).

The integrity that internal auditors demonstrate creates trust that is necessary before reliance will be placed on their judgment by others. It is therefore required of internal auditors to be authentic, accountable and meticulous, and to comply with the necessary legislation, contribute to the ethical objectives of the organisation they are involved at, and not to partake in illegal activities that would bring the profession into disrepute (IIA, 2013:2). Ray identified the qualities required for a well-run IAF to include independence and objectivity, in-depth understanding of the organisation's core values, strategy and vision, competent audit staff, an effective quality review process and an effective way to measure the value-added by the IAF (2009:10).

Hass *et al.*'s literature review on internal auditing identified thirty different skills/competencies internal auditors need to be able to cope with the expanding responsibilities. Some of the skills identified by Hass *et al.*, include conflict resolution, facilitation, interpersonal, interviewing, problem identification and solution, and relationship building (2006:844). Ray found that the majority of IIA members have, at minimum a bachelor's degree and the largest percentage of members held a professional certification, Certified Public Accountant (CPA), and not a professional Certified Internal Audit (CIA) qualification. Obtaining a CIA qualification is critical in demonstrating proficiency and maintaining the skills set for internal auditors thereby ensuring continuing professional education (2009:11).

Regarding what is expected of internal auditors in the workplace, Fourie suggests that internal auditors should not only demonstrate technical skills but also behavioural skills when expressing professional opinions on performance, quality, governance, and control of organisations. The integrity and credibility of internal auditors become especially important for internal auditing to demonstrate they are doing justice to the definition of internal audit (2014:3). This view is re-iterated in the document issued by the IIA that spell some of the skills that internal audit staff should possess. These include internal auditors having practical knowledge of the business as a whole, leadership skills, communication, methodical and critical thinking skills, and strong scepticism. It is also considered necessary for internal auditors to be autonomous, competent, and assertive to command respect while fulfilling

their responsibilities. Internal auditors need to possess emotional intelligence to be able to identify the best way to communicate with the auditee and management, to build trust and provide effective assurance. Due to the nature of the roles and responsibilities of internal auditors, the IAF must have a high enough statute and a clear mandate (IIA, 2018:7).

The 2016 CBOK study on benchmarking internal audit maturity among other things measured if internal audit staff had a mixed background of traditional auditing skills and industry knowledge complemented with general business competence, critical thinking, and leadership skills. Another measurement area focussed on whether structured, documented, and diversified training programs for internal auditors were provided. The research indicated that a global average of 53% of the CAEs report that their staff has an equal mix of traditional auditing skills and industry knowledge whilst 34% of the staff had more of the traditional accounting and auditing profile (IIARF, 2016:16). The study further reports that a significantly larger percentage of staff with an equal mix of traditional auditing skills and industry knowledge fully conform to IIA standards. It is also reported that in 53% of the cases, a training program is not developed or is developed on an ad hoc basis only (IIARF, 2016:18).

Communication (written and oral) is also deemed one of the important competencies of internal auditors as it forms part of the interaction with different role players discussed in section 2.8. Communication takes place from planning the audit up to the communication of the result with auditees according to the standards (IIA, 2016:14-20; Motubatse, 2014:54). The IAF also communicate with the AC on various occasions, such as the approval of the risk-based internal audit plan as well as the report on the status of implementation of the risk-based internal audit plan amongst others (Sarens & De Beelde, 2006a:18; Motubatse, 2014:68-69). Likewise, communication also takes place between the IAF and the external auditors, where the audit scope is discussed so as not to duplicate efforts, and to help determine the external audit reliance on the work done by the IAF (Yee, Sujan, James & Leung, 2008:157; Motubatse, 2014:74).

Ethical decision-making is also considered one of the competencies. O'Leary and Stewart conducted research on the ethical decision making of internal auditors and the impact of corporate governance mechanisms on those decisions including the influence of the years of experience in internal auditing's impact on ethical decision making. The corporate governance mechanisms were AC support; management integrity regarding accounting policies and pressure on internal audit; external auditor characteristics and the

organisational code of conduct. They found that internal auditors were generally sensitive to ethical dilemmas but were not always confident that their peers would act ethically. The only corporate governance mechanism that was positively associated with internal auditors' ethical decision making was a higher quality external audit function. They also found experienced internal auditors adopted a more ethical stance in some cases. They recommend training and the provision of support mechanisms to strengthen the ability of internal auditors to withstand pressure when dealing with ethical dilemmas (2007:787).

A crucial measurement of independence for this study is the reporting line of the IAF where the IAF reports directly to the AC and not to executive management. Goodwin and Yeo support this notion and highlight two factors that affect internal audit independence and objectivity as internal audit's relationship with the AC and the use of the IAF as a management training ground. It is argued that this practice might affect individual objectivity because internal auditors may be reluctant to withstand pressure from an auditee who could be their future supervisor (Goodwin & Yeo, 2001:107).

Internal auditors thus need to have the necessary competencies and show certain characteristics to fulfil their mandate. These competencies range from objectivity, independence, decision making and communication amongst others. Some of these competencies can be taught and some are intrinsic. The role of the IAF in local government has been topical and some of these studies are discussed in the next section.

2.10 POSTGRADUATE STUDIES: INTERNAL AUDIT AND LOCAL GOVERNMENT

The literature review revealed limited academic research in the area of internal auditing and the public sector (Gabrini, 2013:2) and local government, specifically the measurement of the effectiveness of internal auditing in local government. This section will briefly summarise and analyse the post-graduate research completed in the area of this study.

One recent study on internal auditing in local government was completed by Gabrini (2013). The research was conducted on the effect of internal auditing on governance and specifically examined if the results of external audits may be used as an objective measure of internal audit benefits. Internal auditing focuses on internal controls, and because of the link between internal controls and results of financial statements and external audit and the role and objectives of internal auditing, this measurement tool seems appropriate. Data from 162

municipalities (cities) in Florida were used to determine if the presence of internal auditors reduces the likelihood of the municipality receiving findings in the independent external annual audit of their financial statements. Gabrini used the legitimacy theory to examine the nature of the oversight function of governance that internal audit fulfils thereby protecting the legitimacy of the organisation. The results of the study find that objectively defining the benefits of internal auditing may not be possible but instead internal auditing benefits, while real, may largely be abstract or symbolic (2013:viii). Although there are lessons to be learnt from the research related to this study, one of the major differences is that having internal auditing for local government is voluntary in the USA whilst it is compulsory in South Africa.

Five studies on internal auditing in the public and private sector, relevant to this research, have been completed in Africa over the last six years. In 2012, Njoroge completed a study on the factors that contribute to the effectiveness of the IAF in public universities in Kenya using the case study design. Njoroge found that factors contributing to the effectiveness of internal auditing include professional proficiency, quality of audit work, organisational independence, career and advancement and top management support (2012:x).

A study on internal auditing in Africa was completed by Sosthenes in Tanzania in 2013 on factors influencing internal audit operations in electoral bodies. Factors investigated included the extent to which internal audit standards are adhered to; challenges facing effectiveness in internal audit and to identify ways in which the challenges can be addressed. The findings revealed inadequacies in adherence to internal audit standards, such as failure to carry out internal audits regularly, lack of professional qualifications among internal auditors and internal auditors not acting in an objective and independent manner. The findings of the research also revealed various challenges that impacted negatively on the effectiveness of internal auditing, including lack of independence from the employer, inadequate internal audit skills, insufficient resources, lack of cooperation from staff, limited transparency and openness, and management not being committed (Sosthenes, 2013:vii).

Another Tanzanian study was completed by Mbura which assessed the efficiency of internal audit units in improving financial management in Local Government Authorities focussing on the independence, capacity, implementation of recommendations and compliance to IIA *Standards*. The results of this study indicated inadequate support from top management, lack of independence of internal auditors, inadequate human and financial resources, and absence of quality assurance mechanisms (2013:v).

Hailemariam investigated the determinants of internal audit effectiveness in selected Ethiopian public sector offices. Hailemariam found that management support, existence of adequate and competent internal audit staff and the availability of an approved charter contributed significantly to internal audit effectiveness (2014:iii). Tadesse completed a study on the role of internal audit in promoting good governance in commercial banks in Ethiopia and found the perception was that internal audit practices did not include value-added activity. There were low levels of implementation of audit recommendations, the audit charter was not well-communicated and internal audit was not independent. Management also did not support the IAF sufficiently (2015:vi).

In South Africa, eight postgraduate studies on internal auditing, relevant to this research, have been completed since 2005 of which one relates to the private sector, six to the public sector and one to both. Of the six studies on internal auditing in the public sector, four focussed on national departments and provincial departments and two on local government.

In the private sector, Lewis analysed the relevance and the value of the written assessment on the effectiveness of internal financial controls in a combined assurance environment in the financial services industry from the perspective of the CAE (2015:ii). The researcher found that organisations within the financial services industry have different perspectives about the written assessments on the effectiveness of internal financial controls and each organisation should develop their own blueprint of the written assessment process. The researcher concluded that internal auditing has a critical advisory role and is in the best position to coordinate combined assurance and is seen to be independent and objective to competently complete a written assessment of the effectiveness of internal control (Lewis, 2015:130 -131).

Public sector research includes that of Matthee, where the researcher aimed to determine to what extent internal auditing can contribute to good governance and supply chain management for empowerment using the case study of Learner Transport Services, an initiative instituted by the Western Cape Education Department (2005:iv). Matthee concluded that internal auditing can play a vital role in evaluating the supply chain and the inherent and realised risks that effect the efficiency of the organisation in meeting the developmental and equitable challenges referred to in the Supply Chain Management Framework (2005:109).

Relevant for the purpose of this research, though not focusing on internal auditing specifically, van der Nest completed a study on ACs in 2006. The researcher investigated the composition and characteristics of ACs in national departments, compliance with best practice and the perceived effectiveness of the ACs. Part of this study also investigated the effectiveness of the support from the AC to the IAF and the Office of the Auditor-General (external audit) in the achievement of best practice auditing in government departments (2006:219). The results indicated that a low percentage of ACs (58%) evaluated compliance of internal audit to the Standards and recommended that ACs should ensure a process is developed to evaluate internal audits' compliance with the Standards (2006:167).

In the same year, Mjiyako completed a study on the impact of internal auditing on South African local government for the period 1994-2004. One of the findings was that only 22.8% of municipalities were rated as normally complying with the IIA standards after external assessments for quality assurance purposes (2006:131; 135). Since the completion of these two studies in 2006, many developments in the area of internal auditing in South Africa has taken place. The Internal Audit Framework (2009), Risk Management Framework (2010), two more King Reports (2009 and 2016) and other guidance documents have been issued for the internal audit activities in South Africa.

A study by Janse van Rensburg in 2014 focussed on internal auditing in the public sector with a single case study on a national department. The purpose of the research was to assess whether the public sector IAF is sufficiently capable and how the capability can be measured (2014:iii). Janse van Rensburg concluded that the audit capability model issued by the Institute of Internal Auditors Research Foundation is an appropriate measurement instrument that can be applied in the South African context taking certain limitations into account (2014:188).

In the same year, Pule researched the nature and scope of internal audit systems and the extent of management support and opportunities and challenges faced by internal auditing in the North West Province. Pule found that most of the respondents indicated the existence of an internal audit department under the control and direction of the AC. Respondents overwhelmingly agreed that internal audit provide advice on the appropriateness of identified risks and provides assurance on completeness, credibility and timeliness of financial and operational information. In most of the cases, departments and the internal auditing agree

on the proposed scope and respondents felt that internal auditing was sufficiently capacitated to fulfil their roles (2014:84-88).

Fourie investigated the work-readiness of internal audit university graduates to determine if an educational expectation gap exists between expectations from employers in internal audit practice and actual level of internal audit capability (2014:ii) using the quantitative approach. The population of the study comprised of internal auditors on the IIA (SA) membership database, spanning from both the private and public sectors (2014:114). The results indicated a significant educational expectation gap between expected and actual level of skills capabilities, including technical and behavioural skills, for internal audit trainees entering the workplace (2014:218).

A qualitative study focussing on the customers' perceptions of the work performed by the IAF in the public sector using the National Treasury as a case study was completed by Motubatse. The study included identifying the role of the IAF in the public sector in relation to its customers; discussion of strategies to meet the customers' expectations; determination of the perceptions of IAF customers on internal audit work performed; determination of the customers' expectations; and perceived challenges facing the IAF in the National Treasury (Motubatse, 2014:v). The study used three sets of guidance to measure the meeting of customers' expectations including the International Standards for the Professional Practice of Internal Auditing (Standards), the Quality Assurance Improvement Programme (QAIP) and the Batho Pele principles (2014:64). Key customers of the IAF include the AC, the executive and senior managers, the programme and operating managers, and the external auditors (Motubatse, 2014:4). The results of the study showed that customers were reasonably satisfied with the work performed by the IAF and considered it to be an effective tool adding value to National Treasury's governance. The areas of improvement suggested by participants included for the IAF to focus more on areas that the executive and senior managers are responsible for and demonstrating an understanding of the organisation and the expectations of their customers. Regarding the structure, the need for the IAF to be at a strategic management level, in accordance with the then relevant King III was expressed by participants (2014:165-166). At the time of researching all the above South African context research projects, either King II or King III was relevant.

A recent study completed by Sepuru scrutinised the performance of the IAF's roles and responsibilities as a mechanism to reduce service delivery protests in municipalities. The

study was developed under the background of the IAF being a legislated function aimed at strengthening governance systems as per the MFMA. The study revealed that the IAF can indeed assist management to provide services to communities by strengthening control systems, and that the IAF is already playing this role (2017:iii-iv). Mamaile developed a framework to evaluate the IAFs at municipalities in South Africa. Mamaile used the audit reports for all the municipalities over a period of five years and the results revealed that the IAF within many South African municipalities do not fulfil their responsibilities. Oversight of the IAF was found to be inadequate, IAF's were not fully capacitated with skilled, experienced staff, the IAF's did not contribute positively to the audit outcomes and senior management failed to take the IAF seriously (2018:ii).

This research has been completed after King IV was issued thereby incorporating the latest governance code. The above studies provided valuable information for purposes of this research and highlighted some of the common challenges in internal auditing that will be explored in the next section.

2.11 CHALLENGES IN INTERNAL AUDITING

Internal auditors worldwide, including in South Africa, experience many challenges as reflected in the literature. The financial scandals worldwide and in South Africa highlighted the important role of governance. Organisations are subjected to external audits and external auditors have a relationship with the IAF. However, the accounting officer, CAE and ACC observed that the extent to which public sector external auditors are prepared to place reliance on the work of in-house IAF is low due to staff competency levels as compared to outsourced IAF, to contribute optimally to combined assurance (Erasmus *et al.*, 2014:10).

The perception of other components of the combined assurance model was that the IAF lacked public sector business knowledge; were not supported by management; there was a deficiency in audit action monitoring processes; and that the external auditors preferred not to rely on the IAF work to be the biggest challenges facing public sector IAF. These present shortcomings on the IAF. However, these could be improved upon if managers shared their knowledge with the IAF during consultations, thus informing their audit plan to support service delivery efforts. The introduction of audit action monitoring processes would help to avoid repeat findings and to encourage management commitment. Consultations between the IAF and external audit should be done in line with Standard 2050 to identify limitations

that prevent reliance on the work of IAF and ways to remove these barriers (Motubatse, Barac & Ondendaal, 2015:7-11).

One of the key challenges is IAF capacity. The attraction and retention of competent staff within the public sector was identified as one of the challenges by Asare (2009:26) and Pule and Assan (2016:23). Asare attributed the challenge to *inter alia* unattractive remuneration packages and specialised knowledge required by public sector internal audit compared to private sector internal audit resulting in the unavailability of competent resources (2009:26). The results of Fourie's study on work-readiness of internal audit university graduates indicated a significant educational expectation gap between expected and actual level of skills capabilities, including technical and behavioural skills, for internal audit trainees entering the workplace (2014:218). Motubatse also referred to the need for the IAF to demonstrate their knowledge of the business, improve their knowledge and skills in the areas of financial information, and control and create a culture of consultation and openness (2014:166).

Another challenge regarding information technology (IT) and IT development have been highlighted in 2006 already as IT is playing a key role within the new business environment. IT use by companies are becoming more complex and internal auditors will need to monitor how technology is changing the organisation and be able to ensure identified risks and related controls are adequately managed. Internal auditors will also have to continue to add value by using digital tools for the IAF itself. This will require a digitally enabled IAF that embrace technology, understand it, and are able to effectively audit the processes and use it as an audit tool. There will be increasing pressure on internal auditors to provide assurance on the IT control environment. Using technology some of the stress of limited IAF resources can be addressed. It will be required of internal auditors to receive computer skills training to ensure IT expertise as an alternative to traditional manual audit techniques (Hass *et al.*, 2006:839-840).

The challenges regarding IT for public sector internal auditors were also highlighted during a forum with 52 stakeholders from various countries including Kenya, Uganda, Malawi, and Ethiopia. Some of the key challenges identified at the forum include becoming a digitally enabled IAF and ensuring the correct mix of skills to be able to add value to the ever-changing environment. The forum also identified a possible remedy to broaden the skills set of internal auditors to be the recruitment of talent from other parts of the business and

through co-sourcing (AC Leadership Network, 2018:1; 5-6). In his study on the IAF at National Treasury, South Africa, Motubatse also identified the need for the IAF to up-skill their IT knowledge and experience (2014:166).

Pule and Assan's research identified budgetary constraints and the poor relationship between the IAF and management as some of the challenges experienced by the IAF in the North-West Province and attributed these to the IAF being misunderstood in the public sector. The effect of these is seen in absenteeism of auditees during audits and management's reluctance in considering IAF recommendations (2016:22-23). Motubatse shares the same view regarding lack of management support (2014:166). Through this research and the views of the interviewees, further challenges could be identified.

2.12 CONCLUSION

Corporate governance involves structures, systems, and processes aimed at ensuring that entities are effectively managed, comply with regulatory requirements, and fulfil their mandate towards stakeholders. The IAF is one of the governance mechanisms legislated to assist management in this regard. The IAF's role has expanded from performing independent reviews on the financial system controls to providing value-adding assurance and consulting services to enhance internal control systems and ensure that systems produce quality information to assist management in decision-making. In the performance of these duties, the IAF should abide by the legislation and the IIA requirements. The IAF, in their line of work, interact with management, the AC, and the external auditor and must have certain competencies for this interaction to be productive. However, most IAFs are still not capacitated to fulfil their mandate.

CHAPTER 3

RESEARCH DESIGN AND METHODOLOGY

3.1 INTRODUCTION

Research can be described as “finding a way to a better understanding and explanation through literature and empirical study” (Henning, Gravett & van Rensburg, 2005:xvi), also as a journey that can unearth and generate new knowledge or contribute to the existing body of knowledge (Remenyi, 1996:24).

Upon embarking on research, a decision must be made on which research strategy to follow. This translates into a choice between the different scientific methods that leads to knowledge gathering. There are different methods to choose from, including the qualitative, quantitative (Welman & Kruger, 2001:7-9), and most recently, the combination of the two, which is called the mixed-method approach (Schoonenboom & Johnson, 2017:108). While some hold that quantitative and qualitative research strategies are mutually exclusive, even incompatible, others argue that these approaches can be complementary and benefit from each other. Consequently, researchers are now shifting to a new tradition known as the mixed-method approach to research. The mixed-method strategy demonstrates how combined data collection methods can be useful for deriving answers to research questions (Rule & John, 2011:61). Sections 3.2.1 and 3.2.2 describe the different research strategies and the reason for selecting the qualitative approach using the case study method for purposes of this study, respectively.

3.2 RESEARCH DESIGN

Following the decision on which research strategy to use, it is necessary to decide on the research design. A research design provides the structure to be followed for the collection and analysis of data in a study (Bryman, 2004:27). It is also referred to as the plan followed to find a response to the research questions (Ryan *et al.*, 2002:124).

Different research designs are used by researchers including, but not limited to, experimental design, cross-sectional design, longitudinal design, case study design, and comparative design (Bryman, 2004:26-27). The experimental design compares research subjects and requires a considerable degree of control by the researcher to achieve

purposes of prediction and generalisation (Rule & John, 2011:60-61). The cross-sectional design identifies the relationships between the given variables at a particular point in time but cannot explain how these relationships came about (Ryan *et al.*, 2002:84). The longitudinal designs are particularly helpful to provide data over an extended period and to discern trends in social attitudes such as voting behaviour (Bryman, 2004:46). The case study design comprises the study of a single unit of analysis with the possibility of providing rich insights into the case (Rule & John, 2011:1). The comparative design comprises a study that applies more or less identical methods to different cases (Bryman, 2004:53). In some cases, researchers combine comparative and case study approaches.

The research design of this study follows a qualitative strategy, focused on an exploratory case study of one selected municipality. The unit of analysis is thus restricted to one chosen local government structure. According to Bryman (2004:48) and Rule and John (2011:4-5), the type of research that is based on a single community or organisation conducted in its own location to generate knowledge constitutes a case study. Welman and Kruger agree and confirm that a case study investigates the dynamics of an institution (2001:1). Yin also agrees and states that a case study design enables the researcher to carry out an empirical enquiry of the role and operations of a topical area within its real-life context, in this research, the IAF, and is useful to investigate the “what questions” (Yin, 1994:13).

The following sections describe the research methodology followed during the research including the choice between the quantitative and qualitative research strategy, the motivation for using the case study method, and the selection of the Saldanha Bay Municipality’s IAF as the case researched.

3.2.1 Qualitative method

The two main strategies used for research are quantitative and qualitative research strategies (Bryman, 2004:19). Erickson describes the difference between qualitative and quantitative inquiry as follows: “From Latin *qualitas* refers to a primary focus on the qualities, the features, of entities ... while the contrasting term *quantitas* refers to a primary focus on differences in amount. ...” (2011:43).

Brynard and Hanekom differentiate between the two strategies by describing the quantitative method as analytical research with the rationale of arriving at a universal statement whilst the qualitative method is the production of descriptive data (2006:37). Rule and John

(2011:60-61) agree and further elaborate that quantitative research mostly makes use of research methods such as surveys and structured questionnaires. Quantitative research aims to determine universal trends by translating data into numbers to perform statistical analysis. On the other hand, qualitative research is frequently viewed as a process of coming to knowledge in which the researcher and the context (including the subjects or participants) are in constant interaction (Bryman, 2004:19-24).

King, the chairperson of the South African King Committee, recommends the use of qualitative studies for corporate governance, by saying: “Good governance requires a qualitative approach, not a mindless quantitative one. It requires integrity, objectivity, transparency, and accountability, built on a foundation of intellectual honesty” (IFAC & CIPFA, 2014:5).

Due to the unique and complex environment of local government and the various factors impacting on individual municipalities, following a quantitative approach would not enable the researcher to achieve the research objectives and obtain responses to the research questions. Although Carcello *et al.*, identified an advantage of the use of quantitative methods on governance research to be that it does not only focus on a single variable or a limited subset of governance characteristics, but rather on many governance characteristics that could affect the area being studied (2011:20). The qualitative design is appropriate for this study due to the value added from an in-depth analysis of the effectiveness of the IAF as part of a sound corporate governance structure within the SBM. Given the aim of the research, it is important to obtain first-hand knowledge on this important role that the IAF fulfils in order to strengthen governance at the municipality. IN the next section, the case study as the preferred method is discussed.

3.2.2 Case study

This section includes descriptions of the case study method and the reasons for selecting it for this research. One of the most quoted researchers on the case study method, Yin (1994:13), describes the case study as an empirical inquiry that investigates a topical area within its everyday context, and relies on various sources of evidence and ensures validity through triangulation. Gerring (2004:342) concurs and describes a case study as: “An intensive study of a single unit for the purposes of understanding a larger class of (similar) units. A unit connotes a spatially bounded phenomenon ... observed at a single point in time or over some delimited period of time”.

According to Bless and Higson-Smith, (1995:43) cases uncover the functioning of organisations and permit one to explore their strengths and weaknesses, leading to finding solutions for these organisations. In their discussion, on small samples, Altheide and Johnson (2011:589) concur and explain that even for a sample of one, it might be argued that the relevance is limited, however, the results still matter because they shed light on a problem that goes beyond the one case being examined.

The case study design has been used by various researchers on public sector studies to identify the factors impacting the effectiveness of internal audit services (Mihret & Yismaw, 2007:470; Sarens *et al.*, 2009:90). Mihret and Yismaw, (2007:470) studied a large public sector higher educational institution in Ethiopia to determine how internal audit quality, management support, organisational setting, auditee attributes, and the interplay among these factors, influence internal audit effectiveness. Through four Belgian case studies, Sarens *et al.*, (2009:90) researched the drivers of the support of the IAF to the AC and what makes the IAF an expert at providing comfort to the AC. In South Africa, the case study method was used by various researchers including, *inter alia*, Miso (2011) and Motubatse (2014).

The decision to select the case study design was informed by the unique nature of individual municipalities and the different variables impacting on the performance and governance of the municipalities. Turley and Zaman (2007:782) acknowledge that a case analysis allows the researcher to identify important factors that impact on governance outcomes that would otherwise not have been picked-up through the scrutiny of public documentation. Although case study research design is a widely used design, it is also subjected to much criticism, which is discussed further in section 3.7 under limitations of the study.

The unit of analysis in this selected case study is the IAF of the SBM. Limited research has been conducted on SBM, more so on the effectiveness of the IAF. This specific municipality has an IAF in place, and has recently been experiencing service delivery protests. Some of the root causes for these protests were established by Du Plessis (2016:4) in his study on performance management at SBM. The geographical location of SBM in relation to the researcher made it easily accessible and therefore aided data collection. The study aims to analyse the effectiveness of the IAF as part of a sound corporate governance structure at the SBM during the period 2009/2010 to 2017/2018. To address the objectives, answer the questions and establish the “how” and “why”, the case study was the appropriate design.

3.3 DATA COLLECTION

Bryman (2004:27) describes a research method as a technique for collecting data. Research methods are also referred to as realistic ways of obtaining relevant data and then making sense of it (Rule & John, 2011:96). When collecting data for qualitative research, it is important to show that there is triangulation as it necessitates the use of more than one method or source of data collection that enables findings to be cross-checked (Bryman, 2004:275; Rule & John, 2011:108-109). The importance of highlighting the use of multiple sources of evidence to allow issues and theories to emerge in the study is also emphasised by Ryan *et al.*, (2002:154). In quantitative research, the term triangulation is less used but frequently referred to as reliability and proving a “self-audit” of the research process (Bryman, 2004:71). The data collection method used in this research is the review of primary and secondary sources, followed-up by unstructured interviews with parties forming part of the governance structure of the municipality and regularly interacts with the IAF.

3.3.1 Data sources

Data was sourced from primary and secondary sources. Primary sources included annual reports of the municipality, minutes of the AC meetings, internal audit charters and internal audit reports. Secondary data sources included the Constitution, pieces of legislation applicable to municipalities, the AGSA general outcome reports over the period 2009/10 – 2017/18, authoritative academic articles on internal auditing focusing on the public sector, professional literature issued by *inter alia* the IIA, books, dissertations and theses, government publications and guidelines, bulletins and presentations. Unstructured interviews were held with the members who held the position of CAE over the period of the research, the ACC over the research period and the current ACC, and some members of management of the SBM.

3.3.1.1 Review of documents

Over and above the documents that were studied as part of the literature review, publicly available documents published on the municipality’s website were studied. These documents included the municipality’s annual reports, AC reports, and the audit reports of the AGSA forming part of the annual reports for the period 2009/10 – 2017/18. Other internal documentation reviewed included, *inter alia*, internal audit charters, internal audit plans, and internal audit quarterly reports to the AC. A list of all internal documentation reviewed is included as part of the list of references (refer to pages 160 to 164).

3.3.1.2 Interviews

Throughout the literature review, it was noted that interviewing as part of qualitative research was a popular and powerful method to obtain detailed information, as is also confirmed by Fontana and Frey (2008:118) and McNulty, Zattoni and Douglas (2013:190). Face-to-face, unstructured interviews were used to obtain information directly from respondents. This method was used on key respondents, including the two CAEs (past and present), a previous IA employee, an outgoing ACC (followed up with an informal discussion with the current ACC), as well as three members of the executive management. Unstructured interviews were deemed relevant to encourage the participants to freely talk about their perceptions, experiences, and processes. This technique is considered more resourceful compared to questionnaires as it provided the opportunity to ask follow-up questions where the first response was insufficient. It also allowed respondents to ask for clarity from the researcher where they did not understand the question (Masui, 2013:48). The interviews were conducted in a way that promoted participation and continuous flexibility as articulated by Rubin and Rubin (1995:46).

With the respondents' permission, the interviews were recorded and later transcribed into Microsoft Word documents. In cases where interviewees were uncomfortable with the interview being recorded, detailed summary notes of those interviews were made. In accordance with recommendations by Lenz *et al.*, the transcript or the summary notes were sent to the respective interviewee for verification and validation. All interviewees were also told that their responses would be held in strict confidence (2017:4-5).

3.4 DATA ANALYSIS

Once the data is collected it is necessary to analyse and interpret it as part of the research process. Summaries of broad themes from the annual reports, minutes or notices of AC meetings, and internal audit reports to the AC were compiled and synchronised in a Microsoft Word document according to the inputs, process, and output categories of an effective IAF. After the completion of interviews, the interviews were transcribed. The main issues were then summarised to reduce and categorise data into input, process, and output categories for an effective IAF. Specific attention was given to the issues that were highlighted as being important during the interviews and the areas that arose frequently during interviews.

3.5 ETHICAL CONSIDERATIONS

Researchers need to ensure compliance with ethical standards. These include the research not being harmful, avoiding dishonesty, obtaining informed consent, and lastly ensuring privacy and confidentiality. Participants also need to be informed about the potential consequences of the research and that participation is voluntary (Tracy, 2010:847). The necessary approval to conduct the study was obtained from the SBM and formed part of the application process to the Stellenbosch University's Research Ethics Committee to obtain approval to conduct research.

To minimise disruptions, the interviews took place at the participants' offices. Prior to the interviews, the researcher identified herself and explained to the participants what the research entails including the purpose and scope of the research. Participants were also informed that their participation was entirely voluntary, and they could withdraw at any time should they so wish. Furthermore, the participants were informed that their responses will be treated in a strictly confidential manner and will be kept safe. Participants were assured that their anonymity will be ensured. This helped to make them feel comfortable whilst participating. Only the researcher has access to the information as it is uploaded and stored in a password-protected document. The dissemination of the results is in the form of a completed masters' thesis.

3.6 ISSUES OF TRUSTWORTHINESS

Some of the criticism against qualitative research and the case study method can generally be addressed by applying measures to ensure trustworthiness. For the research to be trustworthy it needs to be reliable, meaning the observations show uniformity and the results get replicated (Saud & Marchand, 2012:7). The alternative criteria to evaluate qualitative research as compared to quantitative research has been identified by Lincoln and Guba (1985:296-300) to include credibility, transferability, dependability and confirmability instead of the positivist notions of internal validity, generalisability, reliability and objectivity and the researcher followed the criteria to ensure trustworthiness.

With credibility, the researcher needs to demonstrate that the research was conducted in such a manner as to ensure that the subject is accurately identified and described. To achieve credibility in this case study, the researcher linked the findings from the data analysis with the information obtained during the interviews. Triangulation was attained by

including interviews from different categories of participants. Credibility is also demonstrated by the credibility of the researcher and training, experience status and presentation. In the case of Saldanha Bay Municipality, the researcher discussed the findings with the participants to validate the results of the study.

Compliance to the criteria of transferability might be questioned due to the case study focusing on one municipality only. However, despite this study focussing only on the perceptions on the effectiveness of the IAF, the results can be used by other municipalities for information purposes. Dependability includes the consistency of research results and can be impacted by the evidence and reliability thereof. Ensuring the confidentiality of the participants' views as stated in the consent letter and the universities ethics policy ensured conformability was achieved. The trustworthiness of the data can be demonstrated by the detailed transcripts of the interviews provided and assured through the involvement of the study supervisor. This research process followed a consistent approach from the literature review, the data collection, data analysis, and the findings to ensure an adequate audit trail.

The quality of the data was confirmed through triangulation by using multiple data sources. The review of studies on internal audit effectiveness, the IIA Standards, the King IV and National Treasury Guidelines were used as the framework to guide the broad themes covered during the document analysis and interviews. Documents analysed included annual reports of the municipality, minutes of the AC meetings, internal audit charters, plans and reports. This was followed by conducting interviews with parties that deal with the IAF. Through the review of the documents and the interviews, patterns could be established that showed consistency and led to data saturation. During the empirical analysis, the capacity of the IAF including the experience, expertise and qualifications of the internal auditors in the IAF were examined and the perceptions of the effectiveness of internal audit were obtained, thus leading to drawing of conclusions.

3.7 LIMITATIONS OF THE STUDY

Criticism against the use of case studies has also been expressed by some researchers. Flyvbjerg discusses some of these criticisms or misunderstandings. The first is that general theoretical information adds more value; the second is the inability to generalise resulting in little scientific contribution of the information obtained through a case study; the third is that the case study is only useful during the initial stage of the research process; and lastly, the case study shows a bias to verification due to it including the preconceived thinking of the

researcher analysed. However, Flyvbjerg (2011:302-311) also responded to each of these misunderstandings by stating that concrete case knowledge provides more value than the search for predictive theories. He further states that formal generalisation is overrated and an example through case studies can be very valuable. Although the case study can be useful in the initial phases of the research, it is not limited to those research activities alone. Further arguments posit that all methods of inquiry contain elements of bias and summarising case studies is difficult, but it is more the case being studied that is difficult rather than the method applied.

This study has some limitations. The study focused on one municipality and the findings can therefore not necessarily be used to make recommendations for use within local government structures or other municipalities because the research results cannot be generalised due to different contexts. However, the selection of one case is acceptable as Stake states: “What can be learned from the single case? I will emphasize designing the study to optimize understanding of the case rather than generalization beyond” (2005:463).

Obtaining information from the municipality proved difficult due to the work schedules of IAF. However, with regular follow-ups the information was obtained. Securing appointments for the interviews also proved difficult due to the work programmes of the directors, however, those that availed themselves were interviewed. The municipality has five directorates and at least three directors were interviewed. The interview with the MM could not take place during the window period identified and was abandoned seeing that the current MM was not with the municipality during the period selected for the study.

3.8 CONCLUSION

This chapter discussed the methodology including the qualitative, case study method, and the related data collection techniques. The discussion included a description and the motivation for selection. The case study was the most appropriate qualitative research method. The research method allowed the researcher to understand the perceptions in the actual context. The researcher opted for a single case-study. The reason for selecting the case study was to obtain an in-depth understanding of the capacity and impact of the IAF on governance at the SBM. The participants that were selected were those that interact with the IAF including the ACC and executive management as well as the CAE.

The researcher was able to interact personally with selected key participants during the unstructured interviews and obtain information about the perceptions of the value-added by the IAF and the challenges experienced. The data collected through the unstructured interviews were analysed and triangulated to demonstrate trustworthiness.

The major limitation of the study outlined in this chapter is that its findings cannot be generalised to apply to other public service institutions because the study focused on one specific municipality. This limitation is due to the use of unstructured interviews with respondents, and the analysis of the findings from, only the ACC, the executive managers, and the CAE, that limits generalisation due to the uniqueness of the entity studied. The study was undertaken in accordance with the ethical requirements of the University. Measures taken to ensure trustworthiness were discussed to ensure quality control.

CHAPTER 4

CASE STUDY: SALDANHA BAY MUNICIPALITY

4.1 INTRODUCTION

This chapter analyses and interprets the data collected from municipal documentation and the interviews that followed and presents the data as results. The discussion of the results is guided by the research design and method identified in Chapter 3. The study covers the period 2009/10 to 2017/18, the ideal period showcasing the developments in corporate governance requirements from King III through to King IV.

Documents analysed from SBM include the Annual Reports, Auditor-General Reports, AC Reports, Agenda and Minutes of AC Meetings (for quarter 4 (ending in June)), Internal Audit Reports submitted to the AC (limited to Risk-Based Internal Audit Plan (RBIAP) and Status of Implementation of the RBIAP (for quarter 4 (ending in June)) and the Internal Audit Charters. The information gathered was then corroborated by conducting interviews with three members from the IAF (two previous employees and one current employee), three Directors from a total of five and the previous ACC, subsequently followed up with an informal discussion with the current ACC due to time lapse between interviews. The results are presented by categorising them into inputs, process and outputs, a model discussed in Chapter 2.

4.2 SALDANHA BAY MUNICIPALITY

SBM (with Municipal Demarcation Board code WC014) is a local municipality in the Western Cape Province of South Africa. SBM, together with the other four local municipalities (Bergriver, Cederberg, Matzikama and Swartland) form the West Coast District Municipality (DC1). SBM is bordered in the north by the Bergriver Municipality, in the east and south by Swartland Municipality, and the Atlantic Ocean in the west as demonstrated in the map below (West Coast District Municipality, 2018: 11-12):



Figure 4.1: West Coast District Municipality Map

(West Coast District Municipality, 2019)

SBM covers an area of 2015 km² and a coastline stretching for 238 km, and serves the communities of Hopefield, Jacobsbaai, Paternoster, Saldanha Bay, St Helena Bay, Langebaan and Vredenburg. The head office is located in Vredenburg, with satellite offices in Hopefield, Langebaan, Paternoster, Saldanha Bay and St Helena Bay (Saldanha Bay Municipality, 2019). The Municipality is 96.8% mostly urban and had a total population of 99 193 during the 2011 Census (Department Statistics South Africa, 2011).

4.3 DATA ANALYSIS AND INTERPRETATION

A deductive approach to data analysis was employed. The content from the annual reports, minutes of AC meetings and the internal audit reports to the AC were summarised and synchronized in a Microsoft Word document. Following the document analysis process, interviews were conducted and upon completion recordings were transcribed into a Microsoft Word document. The main issues from internal documentation and transcriptions were then summarised to arrange data into the input, process, and output categories for an effective IAF.

4.4 DATA PRESENTATION

The data presented is a result of the researcher's own interpretation of the data. No attempt was done to rephrase any of the information. Data from the documents was extracted as is and the views of interviewed participants were unchanged. Tables 4.1 and 4.2 below present the broad themes covered and the focus areas within the broad themes, and the categories of participants.

Table 4.1: Themes and focus areas for data presentation

THEME		
Input	Process	Output
Focus area		
<ul style="list-style-type: none"> ➤ IAF Capacity <ul style="list-style-type: none"> ➤ Structure ➤ CAE profile ➤ Adequate staffing 	<ul style="list-style-type: none"> ➤ Reporting lines ➤ Compliance with Standards <ul style="list-style-type: none"> ➤ IA Charter ➤ Independence ➤ Risk-oriented planning process ➤ Documenting results ➤ Implementation of a follow-up process ➤ QAIP ➤ Degree of satisfaction by auditees ➤ AC perception of the quality of IAF performance ➤ Combined assurance 	<ul style="list-style-type: none"> ➤ Usefulness of deliverables <ul style="list-style-type: none"> ➤ Implementation of IAF recommendations ➤ Extent of reliance placed by EA on the work of IA

Table 4.2: Categories of participants

Categories of participants		
Category 1: IAF	Category 2: Directors	Category 3: AC
Participants		
1a	2a	3a
1b	2b	3b
1c	2c	

The data is presented according to the themes identified and analysed according to the focus areas. The direct quotations from internal documentation and participants are indicated in *italic*.

4.4.1 Input

The input dimension comprises all staff-related matters and discusses the capacitation of the IAF, specifically the organisational structure, CAE profile, and the staffing requirements.

4.4.1.1 IAF Capacity

The IAF capacity has been identified as one of the key challenges for public sector IAF due to several reasons as mentioned in section 2.11. IAF capacity is viewed as the main contributor to the IAF environment and directly affects the quality of the IAF's output. This section comprises the structure of the IAF, the CAE profile, and adequate staffing of the IAF.

4.4.1.1.1 Structure

Section 2.6.1 of this study documented the legal requirement for the establishment of an IAF within a municipality and that it could either be in-house, outsourced, or co-sourced. The annual reports of SBM acknowledged the existence of the IAF as: *“an independent section in the office of the Municipal Manager at Saldanha Bay Municipality and forms a significant part of governance within the Municipality, thus contributing to ensure good governance and regulatory reform.”* (Saldanha Bay Municipality, 2010a; 2011a; 2012a; 2013a; 2014a; 2015a; 2016a; 2017a; 2018a). Available AC reports acknowledged that *“the internal audit activities are completed by an in-house department in terms of the Internal Audit Charter.”* (Saldanha Bay Municipality, 2014f) with the following addition to this statement *“...and an audit plan approved by the Audit Committee.”* (Saldanha Bay Municipality, 2017e; 2018d). The IAF thus exist at SBM and its activities are performed by an in-house team led by the CAE.

Section 2.7 of this thesis, identified the different matters to be considered when structuring an IAF. Therefore, according to respondent 1a, the IAF structure at SBM was developed based on:

“...your risk appetite and tolerance level that was non-existence. When I started here, we went back to the standards, and what the standards required of us. So, when we started to implement that we decided how we are going to assign our resources and what do we have to our availability. So I have documented a resource plan in terms of hours, how many staff are there, what is the capabilities, what is the leave provision, what is the training provision and what is the unaccounted for hours, what is the planning hours, and we started to build there. Staff recruitment for different positions within the IAF was done according to the requirements for each post within the structure.” (1a)

The following figure represents the organisational structure of the IAF at SBM:

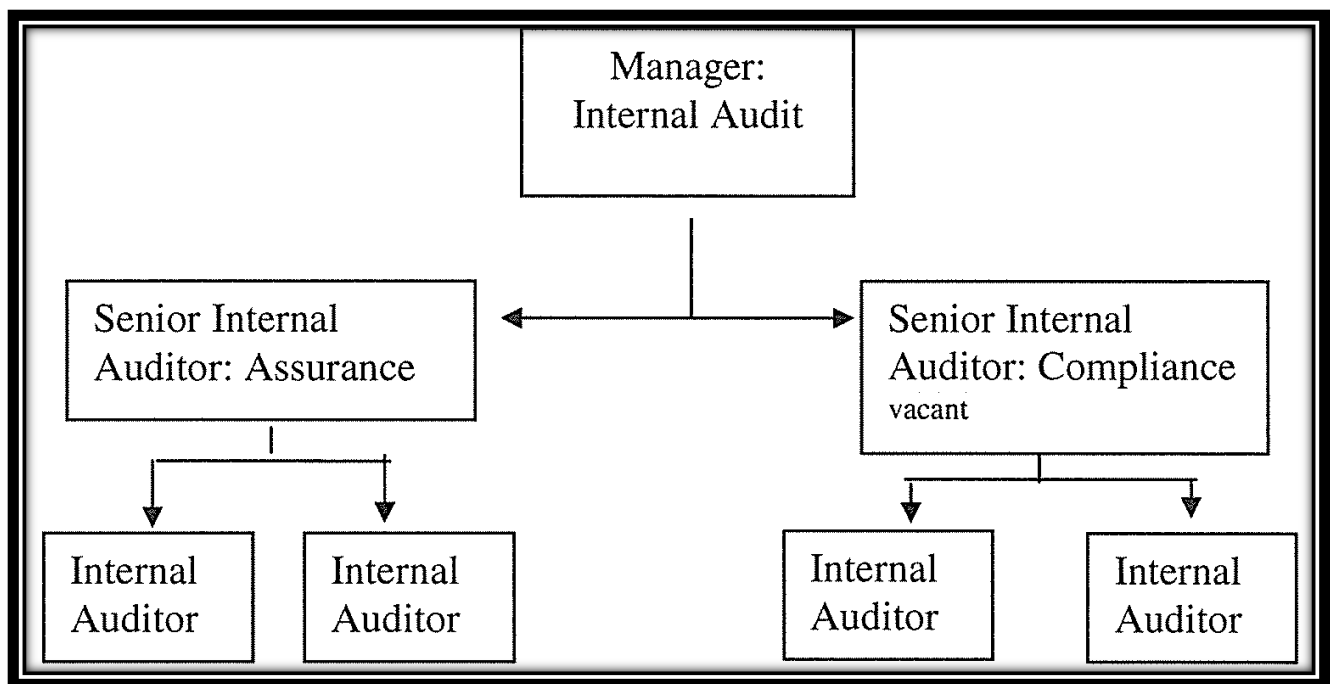


Figure 4.2: Current structure of the IAF at SBM

(Report to AC – The 2014/15 RBIAP)

The structure of the IAF makes provision for seven members, namely the CAE, two senior Internal Auditors and four Internal Auditors. However, some years the Annual Report reported eight members as highlighted in Table 4.3 below:

Table 4.3: Available posts per financial year for the IAF

Financial year	Total posts available
2009/10	Not reported
2010/11	Not reported
2011/12	7
2012/13	8
2013/14	6
2014/15	6
2015/16	6
2016/17	7
2017/18	7

(Annual Reports 2009/10 – 2017/18)

Some of the challenges associated with the variations within the structure include amongst others the funding, transfers and vacancies as highlighted by the respondents:

“...it changes on the approach that the municipality took I think in that point in time because at a certain point the decision was taken only to put annually on your structure what you can fund for that year...” (2b)

“the one senior IA was removed, again because of the funding and then the other one was made unfunded, so the position stayed but was unfunded. So that is the biggest impact from what I can remember why there was a lot of changes – only plan for what you can fund and then plan for everything that you want” (2b)

“...We have an unfunded senior IA position so everything moves up to the CAE to do everything – operational stuff and strategic planning – all that stuff which is not an optimum structure because if i am not here everything runs to a halt..., because of where the municipality is situated it becomes very difficult to attract the right skills set with the right IA experience ... right skill set is in Cape Town and for someone to drive hundred and something kilometres to come and work here, the money must be good and unfortunately the money is not that good so yeah it becomes an issue to collect the right skills set for the department” (2c)

To fill posts within the structure, the recruitment process for the IAF was done in the following manner:

“Obviously each position within the municipality has a job description, so it is signed off, and that job description determines the activities to be undertaken, be it daily, weekly, monthly, quarterly, bi-annually, yearly, so that is the process. Within that process we also define what they call essential skills and preferred skills, so in both these, when we appoint internal auditors at your lower level you will look for a person who has a 3 year diploma without experience, to get them into the system and groom them. But if you need someone who understands the IA environment you will ask for a diploma and 2 year experience, relevant IA experience, and if you go up then it's a degree, with more experience, if it's at managerial level then you take into account if you have dealt with strategic matters thereof and a recruitment is always via a newspaper advertisement. So we didn't make use of any recruitment agencies because we do think that it's an opportunity for internal staff to apply to those within finance that wants to come over with the relevant qualifications or those persons within the area who have qualifications but do not necessarily have the experience” (1a).

Having established how the structure and recruitment of the IAF was done at SBM, the following section details the CAE profile.

4.4.1.1.2 CAE profile

Section 2.8.1 indicated that the necessary qualifications for a CAE includes a post-graduate degree in Auditing and/or Accounting, a professional designation such as a Certified Internal Auditor or other relevant professional designation, with at least five years' experience in internal audit management and to be a member of the Institute of Internal Auditors. All these are meant to enhance the independence of the CAE. The different respondents at SBM had this to say about the appointment of the CAE at SBM:

"...and if you go up then it's a degree, with more experience, if it's at managerial level then you take into account if you have dealt with strategic matters thereof...the emphasis is more on can you lead and direct? Can you interpret policy and implement it according to what is being adopted? Are you able to bring in new things and take the organisations in confidence and how you support, assist, and guide them? And are you able with the resources to your disposal to do magic with those. So those are the four main areas that we normally look at..."
(1a)

"They required a national diploma in IA If I still recall correctly, 5 years' experience in management and then what was the other thing, yoh that was then, 2 or 3 year experience in IA neh, I can't recall that advert now that was years ago, yeah something like that" (1c)

From section 4.4.1.1.1 it can be seen that the municipal requirements for a CAE position are based on an academic qualification, internal audit experience and managerial experience. For the period of the study, two incumbents were appointed to the position of CAE. The respondents had this to say about the expectations when appointing a CAE:

"...being a CAE you are not normally within the normal business process so the focus is not on do you understand the transaction and will you be able to digest what is being documented, test the results and come to a conclusion..., yes, but what we then discovered is the incumbent was not business process orientated. He understands the methodologies, he understands everything, but within the

local government space if you didn't have the experience prior, it's a struggle. So the engagement with the directors and senior managers and the MM is at a different level, we constantly pass each other and what we actually need is that the incumbent is to at least have a sense of what is happening in the municipalities or within government and is able to talk that language and one big mistake that the organisation has made and i think what i have attempt to actually say is the auditors language and the language of the organisation is different and you need a manager or a CAE to be the middle person..." (1a).

Though the CAE was appointed at SBM, the AC with an oversight role was however not directly involved with both appointments as required by the King IV. For the first incumbent:

"...I must say the AC didn't make the appointment, it was an administrative process as the Accounting Officer has all the delegation to appoint or remove someone and they need to follow Council's protocol...So the audit committee was not involved in that and i think that's the reason that position was vacant for about 2 and a half years when they advertised the position" (1a).

For the second incumbent, the process

"was handled similarly, but also provided to the AC for their oversight. So, they weren't part of the recruitment and selection, but there was oversight in terms of it, they knew about it" (1a).

This was corroborated by other participants with the following statements:

"I was also surprised because I didn't see an audit committee member there" (1c).

"I think it's because of how the setup and understanding the setup of the municipality as a local government and understanding maybe how the role of IA is, ...the AC and from my understanding the engagement with her and the MM at the time only after the appointment she was informed or informally consulted - this is who was appointed, but no she didn't have view of the applications, qualifications there but I think it's mostly understanding of the role and how the audit committee fits into the legally prescribed processes" (2b)

The absence of the AC in the recruitment and selection of a CAE seem to have disadvantaged the IAF. This is evidenced from the following responses:

“I’m very blunt to say the CAE should be a Certified Internal Auditor (CIA) with a professional qualification, they don’t have that in the municipality, so I’m concerned about the skills and competencies within IA” (3a).

“...there is still a lot of improvement needed, this organisation is big, the stature of the CAE needs to be at a high level to be able to take on a very strong and excellent management team and very strong senior managers... if you look at the top three, executive, municipal manager, executive directors and then you have senior managers, they are very strong and very competent at what they do, so you need somebody who is strong and is able to take you on, we have seen senior management that can function as a director or municipal manager at any time, so you need people who are specialists, so they are not there. I normally say if you don’t understand my business, you first need to understand my business, so I don’t think they are sufficiently skilled for the type of organisation we have...” (2c)

The appointed CAE, at the time of this research, was in the process of completing the CIA qualification, the highest professional qualification for an internal auditor. An IAF needs a CAE and competent staff to fulfil the IAF role. The adequate staffing component is discussed in the next section.

4.4.1.1.3 Adequate staffing

The corporate governance requirements for the IAF discussed in section 2.6.3 and the Internal Audit Framework discussed in 2.6.4 indicated that the IAF must be well planned, organised, staffed, trained, directed, and monitored to enable the provision of value-adding services. The responsibility of having an adequately resourced IAF for effective functioning lies with the MM and the AC, as they (the AC) are required to assess the IAF effectiveness annually.

Figure 4.2 and Table 4.3 above demonstrated the number of posts available within the IAF structure for each financial year covered in this research. However, staff shortages are a constant matter reported by the IAF (Saldanha Bay Municipality, 2014c; 2014d; 2015b;

2015c; 2016c; 2016d; 2017b; 2017c) and were discussed year-on-year at AC meetings as reflected in the AC reports. Table 4.4 below demonstrates the IAF vacancies as well as for which positions per financial year:

Table 4.4: IAF vacancies per financial year

Financial year	Total posts available	Vacancies	Position
2009/10	Not reported	1	CAE
2010/11	Not reported	0	
2011/12	7	1	Internal Auditor
2012/13	8	2	Senior Internal Auditor and Internal Auditor
2013/14	6	1	CAE
2014/15	6	2	CAE and Senior Internal Auditor
2015/16	6	1	Senior Internal Auditor
2016/17	7	1	Internal Audit intern
2017/18	7	1	Senior Internal Auditor

(AGSA Report 2009/10; Annual Reports 2009/10 – 2017/18)

This indicates that the IAF at SBM experiences staff shortages on an ongoing basis as confirmed by the extracts from the AC reports detailed in Table 4.5 below, followed up by one of the respondents:

Table 4.5: AC comments on the IAF vacancies per financial year

Financial year	Extract from the report
2009/10	<i>“IA did not execute its IA plan completely for the year under review as a result of staff vacancies and re-prioritisation.”</i>
2013/14	<i>“The committee remains concerned about the high vacancy rate and the skills level available in the IA department.”</i>
2015/16	<i>“The main concern is the vacancies and the shortage of skills within the IA.”</i>
2016/17	<i>“The committee remains concerned about the high vacancy rate and the level of skills available in the IA department.”</i>
2017/18	<i>“The committee remains concerned about the high vacancy rate and the level of skills available in the IA department.”</i>

(AC Reports)

“At this municipality, no, they struggle getting people in IA so they have vacancies on an ongoing basis, or people leave, then they have a senior manager within IA that position that is not filled at the moment so the resourcing is poor” (3a)

“...because of where the municipality is situated it becomes very difficult to attract the right skills set with the right IA experience...but we have decided to train our own people but unfortunately those people leave after you have trained and spent a lot of money on them so we have lost about two people in two years which have paid and trained but they are gone so it’s not that bad, it’s not good but we would like people to sit around this minimum of around 4 years, after 4 years then they can leave because they have too much experience then you can get someone” (1c)

The AC went further to highlight the importance of the IAF’s need to receive management support in this matter. It can also be seen that the AC did their part in advising management to fully resource the IAF. This can be noted from the AC reports for the financial years 2013/14; 2015/16; 2016/17 and 2017/18 (Saldanha Bay Municipality, 2014f; 2016b; 2017e; 2018d). These staff shortages had an impact of the IAF effectiveness as experienced staff leave and are replaced by inexperienced staff and *“this impacts time allocation for the reviews”* (Saldanha Bay Municipality, 2016d). This was also highlighted in the annual reports that the IAF faced a challenge *“to provide sufficient assurance services to the organisation on all high-risk areas and to provide and maintain the high level of value add which the department has set for itself”* (Saldanha Bay Municipality, 2014a; 2015a; 2016a; 2017a; 2018a)

It can be noted that constant vacancies on the IAF structure were aggravated by the turnaround time to fill vacancies and impacted the IAF addressing high-risk areas (Saldanha Bay Municipality, 2015b) and corroborated by the respondents as follows:

“I was once forced to advertise 3 times then I said no I can’t do it anymore I’d rather employ an intern and train the intern” (1c)

“It probably took about anything between 3 to 6 months to replace a person or to get someone or to get the process finalised. Because what will happen is you know, even though you have got a resignation you cannot advertise, you need to wait until the person is finished. Once that is done you go through the recruitment/selection process so that item needs to go to the labour appointments committee to say this is the post that i have and i want to advertise it, this is the criteria, and sometimes those meetings get delayed. So, once you agree on that

then advertisement is prepared and then put it out, that's a month already. Then you need to allow for the application process after that month it takes you what we call the longest, all applications need to be listed, that takes about 2 to 3 weeks, then you need to do the shortlisting based on from the department's side what's in the long list so you then identify your candidates that's about 2 weeks, so 3 months gone. Then you go through the recruitment and selection process, or to the appointments committee, you should then then motivate why you selected these persons, you need to look at it in terms of the EE, you need to look at the skills, you need to look at the qualifications, etc. as well as the geographical area where they live because you don't want to incur costs or having a person working here but staying in cape town, you know those practical issues, so that's in month 4, and then it's the interviews or what else you decided is it just the interview or to write the test, so each incumbent needed to write a test, gets evaluated and then go into the interview process, and depending if it's a senior internal auditor or the CAE it was a presentation as well, so once that is done its 5 months, then we have negotiations for the acceptance and once that is done the person needs to work his/her the notice of termination and that's about 6 months then only you get the person here . So that is a constraint and now we have tried to address it through the interns and that shorten our process, so if the intern was on the list, so I think twice we circumvented the whole recruitment and selection process, they had been interns for 3 years, 2 years they were with internal audit they understand how it is working so instead of advertising, you just gonna advertise internally and we are gonna allow the person to apply, you know, it is technically an unfair practice but its fair towards the incumbent because the intern programme is precisely there to build and groom persons for future positions, but we didn't have any comebacks in that regard" (1a)

"...it becomes an issue to collect the right skills set for the department, but we have decided to train our own people but unfortunately those people leave after you have trained and spent a lot of money on them so we have lost about two people in two years which have paid and trained but they are gone so it's not that bad, it's not good but we would like people to sit around this minimum of around 4 years, after 4 years then they can leave because they have too much experience then you can get someone" (1c)

To address the challenges of filling vacant posts the municipality has resorted to hiring interns and developing them to be able to conduct some of the internal audit functions (1c). To strengthen the skill of personnel, the incumbents are sent for learnerships with the IIA and these are reported in the annual reports.

The following table details the training provided for the IAF during the study period to supplement personnel qualifications and to strengthen the IAF to better service their clients:

Table 4.6: Training provided to the IAF

Financial year	Training provided
2009/10	Nothing specific reported
2010/11	Nothing specific reported
2011/12	Internal Audit Technician
2012/13	Internal Audit Technician Excel for Internal Auditors
2013/14	Occupational Health & Safety Analysis System (Internal Audit)
2014/15	Internal Audit Technician Quality Assessment and Review Training
2015/16	Internal Audit Technician
2016/17	Internal Audit Technician Audit from Cradle to Grave (CACTG)
2017/18	Internal Audit Technician Audit from Cradle to Grave (CACTG)

(Annual Reports 2009/10 – 2017/18)

Although the IAF at SBM experience staff shortages frequently, the activity exists and is organised to be an in-house activity, with a 7-posts structure, led by a CAE. Capacitation is sought through internships and strengthened by training provided by the IIA.

4.4.2 Process

The process section presents the IAF arrangements and an analysis thereof against IAF effectiveness criteria. Areas presented include the reporting lines, compliance with standards, degree of satisfaction by auditees, AC's perception on the quality of the IAF's performance and combined assurance.

4.4.2.1 Reporting lines

Standard 1100 require the IAF to be independent of management and the board, which is only possible when the IAF has a functional reporting line to the AC and an administrative reporting line to management. Reporting to the AC thus allow the IAF to fulfil its

responsibilities and strengthens IAF independence. Sections 2.6.3 and 2.8.3 highlight the responsibilities of the AC towards the IAF. Although one of these responsibilities includes ensuring that a competent and objective CAE is appointed, that is not the case at SBM as discussed in section 4.4.1.1.2. At SBM this role is rather the responsibility of the MM, with the AC only providing oversight on the matter.

On the matter of an independent IAF as required by standard 1100, evidence from the annual reports states that for the period covered by the research, the IAF *“is an independent section in the office of the Municipal Manager at Saldanha Bay Municipality”* (Saldanha Bay Municipality, 2010a; 2011a; 2012a; 2013a; 2014a; 2015a; 2016a; 2017a; 2018a). This is also corroborated by the respondents:

“They are supposed to be reporting functionally to the AC and administratively to the Municipal Manager, and functional reporting includes quite a number of responsibilities and I think most of the responsibilities are actually performed by the AC, we approve the audit plan, we sign off the audit charter, etc., we recommend the positions to be filled, etc.” (3a).

The IAF reports *“directly/functionally to the AC and administratively to the Municipal Manager” (1a).*

“On the structure, administratively we report directly – always to the Municipal Manager” (1b)

“Administratively to the Municipal Manager, that is for my leave, and all other stuff like office space and all that stuff, but functionally I report to the AC, it’s all about my work, everything, plans, approving of the RBIAP, staffing needs” (1c)

Thus, the AC at SBM is responsible for the approval of the IAF’s charter, plan (including resources and performance relative to the plan), scope and resource limitations as evidenced in the minutes of the AC (Saldanha Bay Municipality, 2014c; 2015b; 2016c; 2017b; 2018b). Therefore, the requirement for an independent IAF is satisfied.

4.4.2.2 Compliance with standards

As a minimum, an effective IAF is one that is seen to be compliant with at least five standards, namely having a charter, independence, risk-oriented planning process, documenting results, and implementation of a follow-up process (Lenz *et al.*, 2014:128). The sixth standard deemed important for this study is the quality assurance and improvement program (QAIP).

4.4.2.2.1 Internal Audit Charter

The charter is a statement of purpose, authority, and responsibility for an IAF as discussed in section 2.6.2.1. The CAE is thus mandated to prepare an internal audit charter periodically and present it for approval to the governing body. The IA charter is found to be an existing document at SBM, and its format has evolved over the years to comply with the Standards. The CAE works together with the AC and Management to compile the IA charter as confirmed by the respondents:

“Your internal audit manager (CAE) together with the audit committee, however there is input from the municipal manager, directors partaking in the process to understand what is being said there so that there is a buy-in, because whatever you put in the charter to some extent you need to evaluate whether or not what you are doing and saying is still correct. And also, the charter even though the AC approves it, if it’s a policy of council, this is dictating how staff will do it or goes about doing their business, it also needs to go to Council and Council endorses it. So, it’s a two-fold process but at the same time it is also then how do we evaluate the interpretation thereof” (1a)

“Yeah, the IA charter is accessible and is on the website as well and also me being part of the AC, it is a standing item on our agenda and if there’s any amendments they would be discussed there” (2a)

“Yes, and we even have input into it as management in terms of the charter when they were developing it and recently they have just renewed it and when we had input, we had a serious discussion” (2c)

Legislative changes, changes to the standards or new operational/methodology requirements, or changes in AC requirements and/or methodology are some of the

requirements that necessitate the submission of the IA charter and methodology to the AC for approval. Over the period of the study, 2009/10 – 2017/18, the CAE was responsible for reviewing the charter and submitting it to the AC for approval on an annual basis as confirmed by the respondents:

“...so, the standards was the baseline. If the standards was changed, this is how we do it, and I think the significant change that I can recall one that we may have in the years, but I don’t think we ever since is the whole focus on the combined assurance. Yes the charter was there so normal things were being done but when the institute places bigger focus and emphasis on combined assurance then we needed to bring in that area as a focus area, strategically aligned to the charter, into the audit methodology, etc.” (1a)

“It was physically reviewed annually but the submission only done when necessary, I know a lot the AC minutes they might have discussed this to say ok we have reviewed it but there is no significant changes, but the document never physically went to it to say this is the document that was considered this was the changes, only when there were significant changes the charter was updated then the formal document was taken, but otherwise I have to refer back to the minutes but I think at least annually it was discussed” (1b)

The IA charter is also published on the municipal website as part of the information and documents published on the website to satisfy the Service Delivery Budget Implementation Plan section of Governance: Assurance Function. It should be noted, however, that this is an outdated version.

4.4.2.2.2 Independence

Independence is regarded as one of the enablers for the IAF to add value to an organisation as discussed in the 2006 CBOK. Independence is thus determined by these identified reporting lines as discussed in section 4.4.2.1. During this research, the annual reports of the SBM as well as the AC reports from 2009/10 to 2017/18 were scrutinised for IA independence statements by the researcher. The following quotes from the annual reports and AC reports indicate independence:

“The head of internal audit function reported functionally to the audit committee and had unrestricted access to the audit committee chairperson” (AC Report, 2009/10)

“The IA activities are completed by an IAA that performs the work in terms of an IA Charter and an audit plan approved by the AC.” (Saldanha Bay Municipality, 2014f; 2016b; 2017e; 2018d).

The independence of the IAF at SBM is further acknowledged in the IA charter (under the Independence / Authority of IA section), specifically quoting the two reporting lines, functionally to the AC and administratively to the MM (Saldanha Bay Municipality, 2009a; 2011b; 2012b). Thus, the IAF at SBM is perceived to be independent by all parties concerned as determined by the organisational and reporting structures as per Standard 1100.

4.4.2.2.3 Risk-oriented planning

The Public Sector Risk Management Framework requires the IAF to ensure risk management processes are effective as discussed in section 2.6.4.4. During this research, the annual reports of the SBM as well as the AC reports from 2009/10 to 2017/18 were scrutinised for evidence of risk-oriented planning. At the beginning of the study period, risk management was not functional at SBM. The IAF was then tasked to temporarily oversee risk management as per National Treasury Public Sector Risk Management Framework prescripts (Saldanha Bay Municipality, 2010a). This practice resulted in the IAF developing the Risk Management Policy, Risk Management Strategy and Fraud Prevention Plan as evidenced below:

“In the absence of dedicated resources to fulfil the risk management function the IIA performed risk management functions, including developing a risk management policy and fraud prevention plan and organizing and co-ordinating risk assessments within the organisation with the assistance from Provincial Treasury.” (Saldanha Bay Municipality, 2011d)

I think we started off in late 2010/11, in the absence thereof, just to build on this policy and strategy documents, it took us about a year and a half just to get that in place but the objectivity was still an issue and I kept reminding the MM that

whilst I'm here I will do it but I will not take ownership thereof, it's your responsibility your duty so that we can get the risk assessment on which we base our plan on. Later we needed to venture into assigning that specific role to an internal auditor just to look at the risk management activities within the department" (1a)

With the IAF involved in setting up the risk management function, the IAF did not review risk management, instead this task was performed by Provincial Treasury, and thus the IAF's objectivity was not impaired as confirmed by the respondents:

"It didn't, not materially it didn't have an impact on the objectivity because what we decided on is instead of focusing on risk management process, the review thereof, we asked province to do the assessment, so they did what they have the municipal governance review and outlook process, so they looking from that angle into what we are doing, and we focus on the business process audits and compliance, and yes we built the risk assessment aspects into it, but we are testing the control effectiveness and control efficiencies in that regard". (1a)

"We never, objectivity not at all, because we never provided assurance on risk management, so that part of assessing risk management effectiveness, those audits were never done but the extent to what we did is we only consolidated, requested the updating of the risk registers and consolidating them and to I think quarterly, myself and ... has sessions with the directors and some managers just to facilitate the process and to emphasise certain methodologies to apply when they do registers. So, the objectivity on how we engage on it was never impaired because we stopped at that point by facilitating the process and we were never exposed to be providing assurance and that warrant objectivity because we never provided assurance" (1b)

Standard 2000 requires the CAE to prepare a risk-based internal audit plan that incorporates the priority projects of the IAF with institutional goals. Evidence from the annual performance scorecard for each of the financial years covered in this research indicates that one of the key performance measures for the IAF in each of the annual service delivery priorities is that the RBIAP should be completed and submitted to the AC for approval by end of June

(Saldanha Bay Municipality, 2010a; 2011a; 2012a; 2013a; 2014a; 2015a; 2016a; 2017a; 2018a).

The AC report for 2009/10 and the minutes of the AC for the period of the research indicate that the IAP / RBIAP were presented and discussed at the AC meetings with the exception of the year 2009/10 due to the vacancy in the CAE position for part of the year. The IAP / RBIAP could also be revised and presented at a later stage as and when necessary (Saldanha Bay Municipality, 2010c; 2014c; 2015b; 2016c; 2017b; 2018b). The IAP / RBIAP comprised of a three-year rolling plan (strategic) for the financial years 2010/11 – 2014/15 with the other financial years only reporting the annual plan (Saldanha Bay Municipality, 2010a; 2011a; 2012a; 2013a; 2014a; 2015a; 2016a; 2017a; 2018a). The change in the format of the RBIAP was suggested in the 2012 minutes of AC meeting to include aspects such as:

- *“barriers in not achieving prior year audit plan;*
- *sources used to identify risk areas;*
- *individual staff performance and personal development;*
- *approved timelines for officials to respond;*
- *approach to follow-up audit; and*
- *quality assurance”.* (Saldanha Bay Municipality, 2012c)

However, it should be noted that during the initial years covered by the research period, the absence of a fully developed and implemented risk management process resulted in IAF plans not being risk-based. This was corroborated by the respondents:

“... in the first year (2010) it was based on past factors. It means we looked at what was the type of investigations that took place, what type of complaints that took place, a questionnaire that was issued for people to completed, that formed the basis. In year 2 (2011) we decided let’s leave that and look at the focus areas in the 165 of the MFMA, those areas, that was our first then and we said we are just gonna do this for this year and we deal with it and the AG matters that comes along. And in year 3 (2012/13) we then started with based under risk assessment that was done. So, we still had our compliance, we still had the AG issues, but we

brought in the risk assessments evaluations that was done and we used that as a basis to compile our plan” (1a)

During that period specifically, we didn’t have a fully functional and effective risk management process, so to get the risks that was included, a lot of thorough engagement with management and during the drafting process formal meetings were then held. So rather than now email is sent out to get information, during that period it was physically sitting with them, this is what we identified is there anything that, issues that you foresee to happen and that you need assurance on or that you have identified in the past that you need assurance on. Mostly that, and then the internal audit observations during the reviews. What we also tried to do because of the lack of risk registers we use the, I don’t want to call it compliance audits, the statutory audits where legislation requires us to perform the Performance and the DoRA audits, those were used to do risk based audits to say if you didn’t comply, why didn’t you comply, and what’s the root causes, what’s the associated risks, so try to use that as a mechanism to do risk based auditing but starting from a compliance tick box type of starting point (1b)

Thus, the audit plan was compiled based on consultations with senior management to identify high-risk / areas of concern for inclusion in the RBIAP. Therefore, the IAF plans were initially based on past factors, then transformed to focus on compliance, and eventually from 2014/15 onward, with risk management maturing within SBM, IAF plans started to be informed by risk assessments. The following table illustrates the number of risk-based audits completed and reported on in the annual reports:

Table 4.7: Risk-based audits included in the RBIAP per financial year

Financial year	Risk-based audits	
	Planned	Performed
2009/10	0	0
2010/11	0	0
2011/12	0	0
2012/13	0	0
2013/14	0	0
2014/15	1	1
2015/16	3	3
2016/17	2	3
2017/18	Nothing stated	4

(Annual Reports 2009/10 – 2017/18)

Although the different directorates have risk registers, some still have undefined risks, some lacked controls and could not be relied upon as indicated by one of the respondents:

“Depending on what you want in a risk register, there is risk registers, whether all of them are complete is another question, as I said earlier risk management is still at an infant stage so they are still working on it, making sure that everyone has a risk register that contains everything that ought to be in a risk register. So, they might have a risk register, whether it’s complete or not. So, it’s an ongoing process, it’s a live document that they need to maintain” (1c)

As a result, the IAF currently uses two methods to develop a RBIAP, one for directorates that have reliable risk registers and the other for those still lacking (using the weighting scales to do risk indexation).

“I’d rather show you because explaining is not going to make sense to you. (Goes through the process – different method for directorates that have risk register and another (weighting scales to do risk indexation) where there are no risk registers). Thereafter you look at resources available, number of hours available. All these help me to justify why a project needs to be done. Once the municipality has a fully-fledged risk register then I would not need to do the 3-year rolling plan, I can do a quarterly plan from the risk register”. (1c)

During the 2018/19 financial year an external review of the effectiveness of risk management at the municipality was completed with recommendations. The IAF as part of its responsibilities will monitor the implementation of the recommendations **(3b)**.

4.4.2.2.4 Documenting results

Section 2.6.2 discussed the requirements for Standard 2400 (communicating results). At SBM, it is procedure that upon completion of audits, the IAF prepares a management report that is issued to management for comments and action. This process starts with a draft report that is issued, allows auditees to provide comments on the outcome of the audit and the corrective actions to be implemented. Thus, the communication between the IAF and auditees will take place orally on a continuous basis and through reports as alluded to by the respondents:

“You give them feedback as the audit is on-going because once you throw them with a brick at the end then they will not cooperate” (1c).

“...so, we agreed on that, that they first need to discuss with us that these are the findings and by when are we supposed to clear the findings” (2c)

The Strategic Approach in the RBIAP also lays out the agreed reporting and communications guidelines. The IAF will submit reports to management with a 10 working days response period allocated for management responses. Upon issuance of a final report, management is then given 60 working days to oversee that corrective action on control weaknesses is implemented (Saldanha Bay Municipality, 2017c)).

These management reports are then consolidated on a quarterly basis in a document known as the Status of Implementation of the approved RBIAP and submitted to the AC during the quarterly meetings for review and analysis (Saldanha Bay Municipality, 2015b; 2016c). For the period 2009/2010 – 2017/2018, evidence from the minutes of the AC and IA Reports to the AC attest to this effect. The IAF reports were presented as part of the Standard reports and covered areas such as:

- *“Completed audit reports (Internal control, Compliance, Performance management;*

- *Progress report regarding planned against actual audits completed and planned for the remainder of the year;*
- *Ethical and forensic investigations / other reports; and*
- *Responses to AG findings” (Saldanha Bay Municipality, 2014c; 2015b; 2016c; 2017b; 2018b)*

The detailed scope covered by the status of implementation of the RBIAP report covers the purpose of the report, high level status relating to progress, detailed progress reporting, resources utilised to achieve the implementation status (budgeted vs actual hours), and a summary of constraints and challenges experienced during the quarter, the IA team, final reports included and a section on Municipal Standards Chart of Accounts. Although the status of implementation reports are drafted on a quarterly basis, the quarterly reports are never consolidated on an annual basis, but are summarised in the annual reports, as explained by one of the respondents:

“Not in as much detail, we’ve only listed the audit areas and the statement was we’ve looked at the control effectiveness of what management have implemented and certain areas where there was regression or there were deficiencies, it was reported as part of the IA reports.” (1a)

A review of the status of implementation report for the 2016/17 year highlights challenges that hinder IAF performance in ensuring proper audit and reporting time management. These include:

- *“management not adhering to meeting time and submission of documentation;*
- *availability of information in an acceptable manner;*
- *rescheduling by management making it difficult to discuss management reports”*
(Saldanha Bay Municipality, 2017d)

As much as the IAF presented the challenges that hindered their performance, evidence to support the shortcomings of the IAF in terms of reporting time was highlighted by the respondents. The respondents had this to say on this matter:

“I received reports now in November 2017/18 tax year, I mean it means nothing, you can note it, the latest report for April – June was issued now, I mean its 6 months too late, so it not value-added” (3a)

“If you look at the period of 2014 since I joined, there were a number of challenges, our CAE joined us in 2015, ..., before then there was no CAE, it was a senior manager that had other functions that were seconded to him, so the IAF was not functioning as it should, so if you’re following the AC then there lots of challenges. But in recent years since then there was a well-established IAF, though they went through the transformation like all other departments during the operational review, but there’s an improvement in terms of the report, so if you take talk of the recent 2 to 3 years, but before then there were a lot of challenges that reports were not on time and we had those discussions and understand that the systems and processes were put in place” (2c)

4.4.2.2.5 Implementation of a follow-up process

One of the measures of an effective IAF is the implementation of recommendations by auditees. This, however, is informed by a follow-up process as the IAF needs to follow-up on the implementation of recommendations not only as part of effectiveness assessment but also to ensure improvement of the control environment. Evidence from the RBIAP shows that the IAF at SBM has a follow-up process in place (Saldanha Bay Municipality, 2017c), although it did not work well initially as explained by one of the respondents:

“During that time, for a lot of that period, we for a limited period, we did not use email. Everything was on excel and then keeping a record of all the findings and statuses made it difficult, but now more effectively” (1b)

Thus, the current system is made easy through the use of email that serves as a reminder for the implementation of recommendations as well as to schedule a follow-up audit, as explained by one of the respondents:

“Yeah, if you don’t meet their times, they give you a timeline and a week before the timeline ends they will start calling you, how far are you, can you show us, can we go and do an inspection if that is the case” (2b)

Follow-up audits would then be carried out and reported to the AC. These are corroborated by some of the respondents:

“So, in the final report you say what happened and on the action you say the action has been implemented. So, there is continuous engagement with the client”
(1c)

“Of course, they have got a findings list that agrees the system to say this is outstanding/concluded for us, remember you need your dashboard as a manager to see you don’t want to sit with a finding for too long again the findings be it is also embarrassing as directors if you sit there and there’s red finding that you just never did so it’s important for them to send those findings to us to say you still owe us this this is still outstanding and it also help them because for the directors if you see a lot from me it is embarrassing to you as a director to see that so it helps them in a way to make sure that the findings are being closed” (2c)

4.4.2.2.6 Quality assurance and improvement program

Standard 1300 mandate the IAF to have a quality assurance and improvement program. The researcher consulted the annual reports, IA charters and followed-up with interviews to find evidence on the QAIP. However, evidence from the IA charters indicate that only the 2019 IA charter has a statement on quality assurance and improvement program, but no quality assurance policy in place as yet. Evidence from respondents on the existence of a QAIP state that:

“No, they don’t” (3a)

During my tenure it wasn’t done, we have attempted it, but it wasn’t done. The main reason was that the cost implications thereto because what we then decided is let’s do an internal assessment in terms of what is expected of us, and in terms of our personnel, the layers that you need to have also within the QAIP, those layers were non-existent, so you will never make that target , secondly we had a bit of staff shortage, we wouldn’t meet that, thirdly when we are assessed in terms of what we are doing we were doing about 30% thereof, so instead of focusing on the program to improve it we said let’s just build on the stumbling blocks, and I think the colleagues have gone far, they might be now about 50-60%

conformance which is great I think because change doesn't happen over a year..." (1a)

"So let's say since 2011 till 2017, no, but from 2017 till now maybe, but I will have to get back to you and confirm because I have to wait for the person doing the QAR just to make 100% sure if there is one or not. But operationally some of the processes were there, so continuous monitoring were occurring, there was performance (KPIs) and assessments, there was departmental meetings, there was developmental plans for the staff, so the components were happening but it wasn't formally documented and set out for the AC to have an overview" (1b).

"We don't have a policy, we have a statement, I think in the audit charter, but we haven't developed one yet" (1c).

Evidence from the annual reports on the Service Delivery Performance section for the last four years of the study period (2014/15 – 2017/18) indicates that *"the IAF performance improved as a result of the methodologies applied to ensure that the IAF conforms to the Standards. As a result, Management is positive that an internal quality assurance review would be possible by July 2020, which will place the IAF in a better position to undergo an external quality assessment"* (Saldanha Bay Municipality, 2015a; 2016a; 2017a; 2018a). During the interviews it was established that such an assessment had just been undertaken as explained below.

External assessment

For the period 2009/10 – 2017/18, the IAF was never externally reviewed in terms of quality assurance. However, the year 2011/12 saw an attempt at preparing for an external quality assurance review through its inclusion in the municipal strategic objectives (Saldanha Bay Municipality, 2014a). However, this objective was not achieved due to vacancies within IAF as corroborated by one of the respondents:

"During my tenure it wasn't done, we have attempted it, but it wasn't done. The main reason was that the cost implications thereto because what we then decided is let's do an internal assessment in terms of what is expected of us,

and in terms of our personnel, the layers that you need to have also within the QAIP, those layers were non-existent, so you will never make that target...” (1a).

Efforts to achieve this objective were made and IAF staff attended the Quality Assessment and Review training through the IIA (Saldanha Bay Municipality, 2014d). Although no external assessment was undertaken in the period 2009/10 – 2017/18, it was established that one was undertaken in 2019 as alluded to by two of the respondents:

“The external assessment is happening now. We should get a report anytime next week” (1c).

“... now we went through a process where an external service provider also had to evaluate their work and that for each 5 years that it should be done.” (2a)

Internal assessments

Although no formal documentation could be sourced to support internal assessments conducted, evidence from respondents prove that these were conducted. Three sets of internal evaluations took place, from National Treasury, Provincial Treasury and the performance management system based on the service delivery budget implementation plan. This is the evidence from respondents:

“There are two sets of evaluations that was done, actually three. So the first evaluation was done by Provincial Treasury in terms of Municipal Governance Review and Outlook, and just from the audit perspective they look at the audit committee and the internal audit and all of its functions, is there a charter, is there a strategy, is there a methodology, is there personnel, what’s your training plan, etc...So that’s from Provincial Treasury perspective. Then the National Treasury had a questionnaire, Internal Audit Activity evaluation, which we then send out to the business. So, send it out, they complete it, it comes back, it gets evaluated and reports gets generated in terms of the different areas so that was on that side. And then the third one is within the business, what we call the performance management system and the service delivery budget implementation plan, so each department in the municipality has KPIs, so that third layer is not related to the pre-sets from provincial or national treasury, this

is in terms of the party you can say, is the a RBIAP, do you have a response strategy to all the findings that have been raised? Do you facilitate engagements between departments, or do you grow your organisational staff, etc.? So that's the essence of that part, so we then report on those things. Besides that, there's an individual performance and that gets linked to your job description, if your job description says you must do these tasks, they might be 50 but there's high level areas, let's say 5 high level areas, we use those 5 as evaluation criteria so then we evaluate individual's performance. It must say during my stay within the IA we only evaluated individual performance four years after I think in 2013/14 we evaluated the individual performance assessment and the only reason why I postponed it was when I came here what was being done was not internal auditing in terms of the standards, so we needed to change that, we needed to bring in the risk, we needed to make sure the business understands us, we needed to document certain things and we changed our methodology these was then more acceptance to it. I must perhaps say before I started there was willingness for incumbents to act in the manager position or the CAE position. When I started here, and after our changes, I needed to beg them to go on leave to act in my position so that I can go on leave because there was a total change and implementation and I think that was an indication that we were doing things right and they are now more responsive to what is required, so yeah" (1a)

Currently the internal evaluations include continuous monitoring, performance KPIs and assessments, in the form of post-audit surveys, as alluded to by the respondents:

Yes, during that period, except for in 2017, prior to that we did not use a survey after each engagement, what we did is annually as part of the AC and IA assessment management in the AC, ok, management evaluated the AC, AG evaluated the AC and IA evaluated the AC. Those 3 stakeholders plus the AC assessed IA. So that was the only opportunity that we had to assess IA" (1b)

"Yes, I think almost after each audit they did, they send you the list to say what was your experience. But ask me if I ever evaluated them bad. Yes, I did, can I tell you why? ..." (2b)

“Yes, they have started doing that for every function that they are performing they will come back to evaluate that and recent time I have noticed that they are also having surveys they are conducting in terms of determining what they do so its two fold, its evaluating them on what they have been doing as well as generally in terms of the surveys that they are conducting” (2c)

The results of the surveys are then discussed with individuals for staff developmental purposes, as alluded to by one of the respondents:

“Every project we sit with the person to check what happened, because we issue a client satisfaction survey, if there is stuff that pop up there (people are not happy with something) then we sit with the person, this is the result what is your opinion, not who said what, so that they don’t repeat the same things because we heavily dependent on our stakeholders to cooperate with us because that mess up relationships” (1c)

During interviews it was therefore confirmed that internal assessments are conducted regularly and that an external assessment had recently taken place for the 2019/20 financial year and that management is in the process of drafting actions plans for implementation.

4.4.2.3 Degree of satisfaction by auditees

SBM comprise five directorates and these are classified as the auditees. Of the five directorates, three directors availed themselves for the interviews. The interviews focused on the relationship between IAF and auditees with the aim of gauging the auditee satisfaction. Below are some of the observations by the auditees.

During the initial stages of the research period, 2009/10, mainly due to how the IAF used to conduct their duties, management viewed the IAF as an investigator:

“... So where in the past it was used to build up a case to discipline a person, that changed, and management expectations was instead of you being the policeman, you are actually now able to engage with the internal auditor about how I can strengthen my process... what I have tried to, and what I have done then, is to tell them we are not here to catch you out, we are here to take your process, not my process, your process, evaluate it in terms of, is there enough controls within the

process, that the first, the adequacy test, once you pass the adequacy test and if there's failure I'm not even gonna venture into the control testing, I'm gonna tell you there's failure and I'm gonna give you a proposal and I'm gonna do you an SOP so we've done the map.” (1a).

However, the relationship has since improved as described by one of the respondents:

“IA has been viewed as one of the supporting functions and being the director of corporate services, I understand the role of a support function within the organisation and therefore all the support functions I view them as a partner in my directorate, so IA is a partner that is like HR supporting me and also helping me in terms of as the driver you need to have mirrors to help him to see blind spot, to see the back and to have the 360 degree view of what you want to, so they are actually a partner and the driver in terms of my directorate” (2c).

Thus the IAF started with the co-facilitation of risk identification workshops (Saldanha Bay Municipality, 2010a), have assisted management with the drafting of standard operating procedures and process flow charts (Saldanha Bay Municipality, 2012a; 2013a) as well as showcasing how some business processes, e.g. finance, requires different directorates to work together to ensure high performance for SBM as indicated by one of the respondents:

“...one of the key value adds that we have achieved during the time is also where there is a business process requiring different processes, different departments, different directorates, they were now able to talk to each other. So if I don't get this, I cannot finish this, this impacts high performance, so we were then able in one process flow, the one big one for finance have been able to showcase the gaps, and they have taken it to heart and they follow the process and now they have rectified it. So the expectation was more positive than negative as it was in the past and I think it's primarily because there wasn't a CAE for about 2 or 3 years / 2 and a half years “(1a).

Currently auditees generally view the IAF as a supporting function within SBM and are happy with the improvements on discussions before and after an audit, reporting time, and discussions for the compilation of the audit plan. As a result, management is now more open-minded and receptive to findings and recommendations.

“It was well received because we didn’t make a recommendation that management should strengthening the controls, our recommendation was management must consider the following: 1 document and clearly outlaying the intent of this policy 2 is to create a SOP in terms of this particular areas to address the shortcomings within the transactions 3 is to review that on a regular basis or to align to either a by-law or regulation, etc. What we then say with regard to an engagement is if you do not know how to document the SOP we will document it for you provided you gave your personnel to sit with us. And I think those have been additional things that we have been doing. But then they have accepted those things for implementation” (1a)

4.4.2.4 AC perception on the quality of the IAF performance

Section 2.8.3 discussed the AC’s oversight responsibilities toward the IAF. From the ten-point checklist of the IIA, the AC should assess the IAF performance, appoint the CAE and support and promote the IAF within the organisation. As determined in section 4.4.1.1.2 above, the AC at SBM did not make any of the two CAE appointments during the period 2009/10 – 2017/18 but were notified of the process.

The IAF is required to submit its plans and reports to the AC for review on a quarterly basis. Evidence from the minutes of AC meetings, AC report and the annual reports attested to the IAF compliance to this requirement. During these meetings, the IAF would submit its charter, plans and status of implementation of the RBIAP reports to the AC for discussion and approval (Saldanha Bay Municipality, 2010a; 2010c; 2011a; 2011d; 2012a; 2013a; 2014a; 2014c; 2014f; 2015a; 2015b; 2016a; 2016b; 2016c; 2017a; 2017b; 2017e; 2018a; 2018b; 2018d).

Through an analysis by the researcher, the internal audits planned per internal audit plan / RBIAP for the period covered by the study were compared to the audits completed as reported in the annual reports and are reflected on the table below with reasons for non-completion:

Table 4.8: Compliance with the audit plan

Financial year	Level of Execution	Reason
2009/10	Not completed	<ul style="list-style-type: none"> Staff vacancies (Head of IA) and re-prioritisation
2010/11	Not reported	
2011/12	80%	<ul style="list-style-type: none"> Lack of ability to perform control effectiveness testing due to lack of process design and adequate controls instituted by process owners. Over reliance placed on IAF to guide management actions.
2012/13	100%	
2013/14	95%	<ul style="list-style-type: none"> Administrative reasons, unavailability of resources and time limitations
2014/15	100%	
2015/16	100%	
2016/17	100%	
2017/18	100%	

(Annual Reports 2009/10 – 2017/18)

Based on the information in Table 4.8, there has been consistent performance against the RBIAP from the 2014/15 up until the end of the research period. During these discussions, the AC reviewed IA quality focusing on audit governance, methodology, independence, scope of work and output. Throughout the study period, the AC's main concern was the vacancies and shortage of skills within the IAF and continually highlighted that the IAF should be well resourced to be effective (Saldanha Bay Municipality, 2010c; 2011d; 2014f; 2016b; 2017e; 2018d).

The absence of a risk management process had an impact on the work of the IAF, however there was a way to work around that as can be attested by the respondents:

“...the audit plan, in other words the assignments that they must do during the year, that should be risk-based and if there is no risk register then they have to use their professional judgement in consultation with senior management to determine the areas of highest risk in the organisation...” (3a)

“...I had to use my own experience, what are the important or imagined risks in order to decide what are the important risks that one has to concentrate on, so it means now I have to do my own risk assessments...” (1c)

Since SBM is a government entity, the extent to which the IAF could render value-add through risk-based audits was limited due to the focus mainly placed on compliance audits and this was seen as a contributing factor that hindered value-add:

“I have a big concern when it comes to municipalities and government internal audit activities because there are so many responsibilities that they have in relation to legal requirements that the portion of the audit work that is based on risk is very small so their audit plans, although they say its risk-based, it's very limited risk-based internal audit plans because of the legal requirements and compliance stuff that they must do... they have these requirements that they have to perform audits - DoRA, performance information audits, yeah, its legal compliance they have to do these audits which I don't think add a lot of value” (3a).

The outgoing ACC also expressed concerns about the focus having to be on compliance audits rather than value-adding assignments. This impacted negatively on the perceived value-adding performance of the IAF. The outgoing ACC also alluded to the negative impact the IAF capacity had on the perceived contributions the IAF made to the municipality. The outgoing ACC further raised concerns about the quality of reports, the recommendations by the IAF, and the timeous issuing of reports. However, this was based on the view in 2017/18. A subsequent discussion with the newly appointed current ACC indicates progress on both quality and timeous issuing of reports after inputs and the effort by the outgoing ACC and IAF. The current ACC also indicated that an action plan to further improve the quality of the work performed by the IAF as a result of the external evaluation results have been compiled (3a; 3b).

Although the IAF reported functionally to the AC as discussed in section 4.4.2.1, it should be noted that the AC has never signed off on the performance evaluation of the CAE. This role is fulfilled by the MM, who appoints and signs off on the CAE performance. This finding is supported by the following responses:

“The one responsibility that we don’t fulfil that we should fulfil is the performance evaluation of the internal audit and we don’t do that at this municipality” (3a)

“...we are employees of the municipality, we should abide by the policies of the municipality, so before I am a CAE I am a municipal employee so evaluations happens according to policy, should happen twice a year, the chairperson of the AC can have input” (2c).

4.4.2.5 Combined assurance

Section 2.7.5 included a description of combined assurance and the role of the IAF as part of combined assurance. The researcher reviewed the annual reports and AC reports for the period of the research to identify statements made on combined assurance. Evidence from these documents indicates that *“combined assurance is not fully embedded at SBM pending the full implementation of the risk management process”* (Saldanha Bay Municipality, 2010a; 2010c; 2011a; 2011d; 2012a; 2013a; 2014a; 2014f; 2015a; 2016a; 2016b; 2017a; 2017e; 2018a; 2018d). This finding was corroborated by the respondents as follows:

“Assurance providers, hasn’t during that point in time, hasn’t been identified and/or performing their function” (1b)

“Not yet, but we are going that direction eventually, I think that is one of my stuff that I need to do in the next 2 years so that everyone knows what to do, when, how, and these external service providers, where do they fit in. We have identified our service providers, the ones we know of. Now we need to engage with them to see what is it that they do in order to understand their methodology before we place reliance on their work. The ones that we base reliance on their work is the AG” (1c).

Although combined assurance is not yet embedded at SBM, the AC commends the cooperation between IAF and External Audit and sees this move as a beneficial step towards combined assurance (Saldanha Bay Municipality, 2018d). Therefore, positive steps are being taken toward ensuring that SBM has a fully functional combined assurance framework in place.

4.4.3 Output

The output dimension reflects on the usefulness of IAF deliverables, the extent of implementation of the IAF recommendations, and reliance placed by external audit on the work of internal audit.

4.4.3.1 Usefulness of deliverables

Deliverables of the IAF are the reports issued as well as the recommendations contained therein. Management's commitment to the implementation of IAF recommendations on findings renders the IAF output significant within the workplace (Barac & van Staden, 2014:25).

To place the implementation of IAF recommendations into perspective, the researcher scrutinised the 2008/09 AC report to gauge the status of internal controls at SBM in the period prior to the research period. The system of internal controls was not effective in the year 2008/09 with common causes including *“non-compliance with prescribed policies and procedures, over-riding of controls by management, lack of skills training or inadequate training, lack of supervision and discipline, lack of capacity due to vacancies, inadequate facilities and inadequate security”* (Saldanha Bay Municipality, 2009b). The findings on internal controls were used as a baseline to measure if internal controls within SBM had improved or deteriorated over the research period taking cognizance of the contribution by the IAF.

4.4.3.1.1 Implementation of IAF recommendations

The researcher perused the 2009/10 – 2017/18 annual reports, AC reports, AGSA reports, minutes of AC meeting and the 2016/2017 status of implementation report for statements made on the implementation of IAF recommendations. One of the respondents is of the opinion that IAF recommendations were well received:

“It was well-received because we didn't make a recommendation that management should strengthening the controls, our recommendation was management must consider the following: 1 document and clearly outlaying the intent of this policy 2 is to create a SOP in terms of this particular areas to address the shortcomings within the transactions 3 is to review that on a regular basis or to align to either a by-law or regulation, etc. What we then say with regard to an engagement is if you do not know how to document the SOP we will document it

for you provided you gave your personnel to sit with us. And i think those have been additional things that we have been doing. But then they have accepted those things for implementation” (1a)

Although recommendations were well-received and some participants indicated the value adding role of the IAF (see section 4.4.2.3) evidence from the annual reports and the AC reports for the period 2009/2010 – 2017/2018 suggests that the rate of implementation of IAF recommendations was still generally found to be low as a result of action plans being implemented at a slow pace as summarised on Table 4.9 below. However, for the last two years, 2016/17 and 2017/18, an improvement in the audit findings resolved has been noted.

Table 4.9: Implementation status of the IAF recommendations

Financial year	Statement
2009/10	Follow up audits indicated low implementation rate of management corrective actions.
2010/11	Follow up audits indicated low implementation rate of management corrective actions.
2011/12	Follow up audits indicated low implementation rate of management corrective actions.
2012/13	Not reported
2013/14	The AC noted a slow improvement in the number of external and internal audit findings resolved.
2014/15	Not reported
2015/16	Departments are sometimes slow in implementing external and internal audit recommendations
2016/17	Although recurring findings still occurred, AC noted improvement in the amount of external and internal audit findings resolved
2017/18	Although recurring findings still occurred, AC noted improvement in the amount of external and internal audit findings resolved

(Annual Reports & AC Reports 2009/10 – 2017/18)

To assist with the measurement of whether internal controls within SBM had improved or deteriorated over the research period, the explanations of weaknesses found in internal controls reflected in the AC reports were scrutinised and are indicated in Table 4.10 below:

Table 4.10: Reasons for internal control weaknesses per financial year

Financial year	Reason
2009/10	<ul style="list-style-type: none"> • Material non-compliance with sections of legislation.
2010/11	<ul style="list-style-type: none"> • Lack of documented policies and procedures; • inadequacy of existing policies; policies, procedures and internal controls being poorly understood thus not properly implemented; • lack of management and supervisory review and monitoring relating to performance, compliance with legislation, regulations, policies and procedures; • ineffective human resource management to ensure adequate and sufficiently skilled resources, resulting in numerous instances of non-compliance.
2011/12	No report
2012/13	No report
2013/14	<ul style="list-style-type: none"> • Controls to prevent irregular, fruitless and wasteful expenditure need to be effectively monitored; • oversight of approval of expenditure that deviates from SCM prescripts need to be improved; • plans of action to address control deficiencies need to be properly defined, implemented, and managed to prevent recurring adverse findings; • proper and timeous record keeping needed to ensure reliable financial and performance information; and • better monitoring of compliance with legislative requirements, specifically relating to SCM is needed.
2014/15	No report
2015/16	<ul style="list-style-type: none"> • The IA is doing its best to put systems and process in place. Although the IA is trying, there are some departments who ignore their recommendations.
2016/17	<p>The following areas still need attention:</p> <ul style="list-style-type: none"> • action plans to address improvement in controls to ensure that reliable planned and actual performance is reported; • actions are implemented and managed to prevent recurring findings; and • proper record keeping in a timely manner to ensure reliable performance information.
2017/18	<p>The following areas still need attention:</p> <ul style="list-style-type: none"> • action plans to address improvement in controls to ensure that reliable planned and actual performance is reported; • actions are implemented and managed to prevent recurring findings; and • proper record keeping in a timely manner to ensure reliable performance information.

(AC Reports 2009/10 – 2017/18)

Based on the information above, it appears that there has been an improvement from material non-compliance and various control weaknesses to a point where action plans to

address improvement in controls are compiled and actions are implemented and monitored to prevent recurring findings. The controls to ensure reliable performance information also appear to have improved.

Although internal controls seem to have improved, the IAF also highlighted some of the challenges that relate to implementation of IAF recommendations. These were extracted from the annual reports:

Table 4.11: IAF challenges relating to implementation of the IAF recommendations

Financial year	Reason
2011/12	<ul style="list-style-type: none"> • Lack of ability to perform control effectiveness testing due to lack of process design and adequate controls instituted by process owners. • Policies approved/adopted not enforced and/or monitored resulting in repetitive findings being raised. • Low or partial implementation of agreed action plans by process owners resulting in minimal control effectiveness testing. • Over reliance placed on IAF to guide management actions. • Re-designing internal process to determine workflow and ensure quality documenting results. • Independence and objectivity of the IAF is impaired due to the risk management responsibilities and therefore no evaluation is performed on the effectiveness of risk management activities.
2016/17	<ul style="list-style-type: none"> • Availability, quality, and format of information.

(Annual Reports 2009/10 – 2017/18)

Some of the reasons for the low implementation as communicated by respondents range from late reports, turnaround time, findings not discussed with auditees first, as well as recommendations not linked to legislation. These were corroborated by the respondents:

“...people don’t worry to implement the recommendations of the IAA, so you sit, and I can’t actually blame them because I received reports now in November for 2017/18 tax year, I mean it means nothing, you can note it, the latest report for April – June was issued now, I mean its 6 months too late so it’s not value added” (3a).

“No, if you could relate it to legislation and show them how it could benefit their operations, if you could show them that, some departments are more open to it

depending on their understanding of the role of IA and their ability to understand why you are trying to do that” (1b)

“Yes, agreed turnaround time in most instances during that period wasn’t achieved it always had to be postponed or extended, but ultimately in some way or for even if it is not what we specifically agreed, something was implemented, to an extent to rectify an issue that was identified” (1b)

“...so we agreed on that, that they first need to discuss with us that these are the findings and by when are we supposed to clear the findings because sometimes the time frames are unrealistic so we need to discuss on the time frames and sometimes the responsibility, who is going to deal with that needs to be discussed because sometimes you can give the responsibility to the wrong person then the action is not implemented within the time frame and then we go back and realise that the action was allocated to the wrong person, so it’s important for us to discuss to avoid repeat findings” (2c)

Table 4.12 below attest to the efforts of the IAF in terms of internal controls, however, insufficient oversight and slow or no response to audit findings and implementation of actions plans suggested can be attributed to the regressions in audit opinions at SBM. For the duration of the study period, the following were noted by AGSA as factors that contributed to internal control deficiencies that ultimately influenced the audit opinion, specifically focussing on the IAF role in internal controls:

Table 4.12: Analysis of AGSA audit opinion for the period 2009/2010 – 2017/2018

Financial year	Audit opinion	Factors contributing to the audit opinion related to internal audit role in internal controls
2009/2010	Qualified	<ul style="list-style-type: none"> • Key positions including CAE vacant within the year. • Internal and external audit findings not addressed and internal control deficiencies not rectified. • Lack of enterprise risk management.
2010/2011	Unqualified with findings	<ul style="list-style-type: none"> • Non-compliance by IA related to performance management legislative requirements. • Non-compliance to legislation.
2011/2012	Unqualified with findings	<ul style="list-style-type: none"> • Inadequate follow-up of implementation of internal and external audit recommendations.
2012/2013	Unqualified with findings	<ul style="list-style-type: none"> • Adherence to plan to implement recommendations by internal and external audit not monitored by management. • Limited corrective measures recommended by Internal Audit related to performance reporting were implemented.
2013/2014	Unqualified with findings	<ul style="list-style-type: none"> • Insufficient oversight over compliance with legislation related to expenditure management and supply chain management. • Inadequate actions to implement internal control deficiencies.
2014/2015	Unqualified	<ul style="list-style-type: none"> • No instances of material non-compliance. • No significant deficiencies in internal control.
2015/2016	Unqualified	<ul style="list-style-type: none"> • No significant deficiencies in internal control.
2016/2017	Unqualified	<ul style="list-style-type: none"> • No significant deficiencies in internal control.
2017/2018	Unqualified with findings	<ul style="list-style-type: none"> • Significant internal control deficiencies that resulted in the findings on compliance with legislation related to supply chain management and performance information. • Slow or no response in improving internal controls and addressing risk areas.

(AGSA Reports 2010 – 2019)

Despite continuous improvement in the control environment reflected in Tables 4.10 and 4.11 above, and evident in the positive changes in audit opinion issued by the AGSA up to 2016/17 indicated in Table 4.12, the control environment still appears not to be at an ideal position at the SBM.

The improvements and the regress are also confirmed by the information in the AC reports, where:

- The AC concurred with internal control deficiencies identified by AGSA in 2009/10. In 2010/11.
- The AC identified that internal controls were poorly understood hence were not properly implemented.
- From 2013/14 to 2017/18 the AC noted improvement in internal controls in financial statements, performance reporting and compliance with legislation, except for issues raised by AGSA in 2017/18 which were noted.

Although there have been improvements in internal controls, to which the IAF have contributed through the recommendations, some areas still need attention. However, action plans to improve controls and prevent recurring findings, as well as proper record-keeping have been identified and monitored for implementation.

4.4.3.1.2 Extent of External Audit reliance on the work done by IAF

A pre-requisite for the external audit to place reliance on the work of the IAF was discussed in section 2.8.2 and includes the IAF that has a competent complement of staff that can perform at a high standard. Also, for external audit to place reliance on the work of internal audit they would need to receive sufficient, timely information to enable external auditors to evaluate the nature and extent of work of the IAF on which they may rely.

Due to the IAF not having been quality assured throughout the period of the study, 2009/2010 – 2017/18, evidence from one of the respondents indicate that external auditors refuse to place reliance on the work done by the IAF but rather prefer to use the IAF's work for risk assessment as indicated below:

“They say they use our work for risk assessment, and they say they will place reliance on our work once we have quality assured, not just us but everyone else. I would like to see once our quality assurance has been done what is going to be their excuse” (1c)

Evidence as discussed in sections 4.4.1.1.3 and 4.4.2.5 on adequate staffing and audit and reporting time management portrays the IAF in a bad light for the external audit to place reliance on the IAF work. However, all is not lost as section 4.4.2.7.1 on combined assurance highlights that there is cooperation between the IAF and external audit.

4.5 CONCLUSION

The data presented in this chapter was based on document analysis and corroborated with information obtained during the interviews. The broad themes covered in the chapter include the input, process, and output dimensions of evaluating the effectiveness of IAF. Inputs covered aspects of the staffing component of the IAF, process covered the work component of the IAF, and the output covered the deliverables of the IAF.

The IAF has an organisational structure making provision for seven employees. The IAF is led by a CAE, and between 2009/10 and 2017/18, two separate individuals filled the position of the CAE. These individuals were appointed by the MM without direct involvement by the AC. The IAF constantly experience staff shortages. The IAF is guided by an Internal Audit Charter and Methodology in the execution of their work.

The IAF reports functionally to the AC and administratively to the MM. Although risk management is not fully embedded at SBM, the IAF assisted by facilitating the risk management process during the initial stages of development. This assisted with risk-based planning for the IAF. Despite staff shortages, the IAF managed to comply with the RBIAP for most of the financial years covered in the study. Although there are challenges regarding audit and reporting time, management understands the need for the establishment of the IAF within the municipality and are now more open-minded and receptive to findings and recommendations. However, the implementation rate of recommendations still appears to be low.

The IAF reports quarterly to the AC on the status of implementation of the RBIAP and there is a system in place for the follow-up process. However, due to constant staff shortages that replicates into the IAF losing important skills and competencies, there is room for improvement. The absence of an external quality assurance and improvement program between 2009/10 and 2017/18 has led to the external auditors refusing to place reliance on the work of the IAF. However, collaboration between the IAF and external auditors is promoted by the AC as this relationship will eventually lead to a fully-fledged combined assurance model within SBM.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

5.1 CONCLUSION

The data pertaining to the establishment of whether the IAF at SBM can be considered effective within a sound corporate governance structure was analysed, interpreted and presented in Chapter 4. Chapter 5 addresses the achievement of the research aim and objectives and presents a summary of the research findings. Furthermore, the contribution of this research to academia, recommendations derived from the results, and suggestions for further research pave way for the conclusion.

This chapter necessitates determining whether the research aims and objectives were achieved. Karagiorgos *et al.*, (2010:20) established the existence of a positive relationship between the characteristics of corporate governance and the IAF and encouraged further studies to be conducted to evaluate the exact and possible impact of the IAF on corporate governance.

The research problem identified that despite all recommendations by the AGSA over the years, problems within municipal IAFs still exist where IAFs are deemed not to be contributing to governance as their recommendations are not implemented. This study focused on establishing the effectiveness of the IAF as a part of a sound corporate governance structure at SBM during the period 2009/2010 to 2017/2018. The study employed two research questions to achieve the aim and address the identified problem. The achievement of the objectives of the study are summarised in table 5.1 below:

Table 5.1 Achievement of the research objectives

Objective	Outcomes	Positioning in thesis
Objective 1: Determine the structure and composition of the IAF and its impact within the SBM.	<ul style="list-style-type: none"> • IAF structure allows for a 7-member team, comprising the CAE, two Senior Internal Auditors, and four Internal Auditors (including interns). • IAF is independent and reports functionally to the AC and administratively to the MM. • IAF is compliant with minimum required standards. 	Chapter 4
Objective 2: Determine the support rendered by the IAF to the management of the SBM as part of their governance role during the period 2009/2010 to 2017/2018.	<ul style="list-style-type: none"> • Assisted with risk management in the absence of a risk officer. • This move resulted in the development of a Risk Management Policy and Risk Management Strategy and Fraud Prevention Strategy/Plan. • Organised and coordinated risk assessments and assisted SBM with the compilation of a municipal strategic risk register. • IAF moved towards a RBIAP. • Proper process of documenting results and performing follow-up to strengthen the control environment. • Improved internal control environment that contributed towards the achievement of unqualified audit opinions by AGSA (four years consecutive unqualified with findings and for three years consecutive unqualified). • Identified service providers to be included in the combined assurance model and every constituent's role should be clarified in the next two years. 	Chapter 4

	<ul style="list-style-type: none"> • All of this resulted in an environment where management is of the opinion that the IAF adds value, although there are still areas for improvement. 	
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5.2 SUMMARY OF FINDINGS

The research findings according to the three dimensions for evaluating IAF effectiveness are presented below:

5.2.1 Input

The SBM has an independent IAF team that is in-house, comprising a seven-member team led by the CAE. The research study period saw the appointment of two incumbents into the position of CAE. However, these appointments did not meet the criteria suggested by the King IV on the AC being involved with the appointment of the CAE despite an AC being in existence at the time. The absence of the AC involvement in the CAE appointment process could assist with ensuring that all criteria and skills being considered during the appointment are deliberated on. In addition to the lack of AC involvement in the appointment of the CAE, the study found that the AC does not form part of the process of evaluating the performance of the CAE. The AC involvement could contribute to the identification of important areas of performance enhancement.

The IAF at the SBM repeatedly reported staff vacancies and the loss of much needed skills and competencies, impacting on the IAF's effectiveness. The turnaround time to fill posts is too long and as a result the IAF resorted to appointing intern internal auditors. It could be argued that the time spent building skills, municipal knowledge, and expertise of newly appointed IAF interns impact negatively on available time that could have been spent on conducting more risk-based audits to add additional value to the SBM.

5.2.2 Process

IAF reporting lines at the SBM are separated to comply with independence requirements as per Standards, thus the IAF reports functionally to the AC and administratively to the MM, though there are non-involvement by the ACC on CAE appointment and performance evaluation as indicated in 5.2.1 above.

For the period 2009/10 to 2017/18, the IAF is seen to be compliant with five of the six Standards as identified in Chapter 4. The IAF has an IA charter that is updated as required and presented to the AC for approval. The IAF is independent and played a significant role in the establishment of risk management at the SBM. Although the IAF assisted with risk planning for the SBM, some directorates still do not have reliable risk registers. However, the process is still developing, and this is seen as a positive contribution from the IAF that resulted in the SBM appointing a chief risk officer and the establishment of a risk committee.

The absence of a fully developed and implemented risk management process during the initial years covered by the research period resulted in IAF plans not being risk-based, however, this changed for the better in 2014/15 when the first-ever risk-based audit was conducted, thus setting precedent for the coming financial years. The documentation of audit results were initially not in place, however, this improved and reporting and communication guidelines are in place and adhered to, as well as the implementation of a follow up process that monitors the implementation of recommendations and scheduling of follow-up audits. However, management does not see the IAF as a strategic partner but rather as a supporting function.

For the period of the research, 2009/10 to 2017/18, the IAF was not compliant with standard 1300 (quality assurance and improvement program) as a result of staff shortages, however, efforts to be compliant were made. The IAF staff attended the Quality Assessment and Review training through the IIA to capacitate them for an external review. Although the latest Internal Audit Charter has a statement on quality assurance and improvement program, there is no policy in place to guide the IAF efforts on the matter. The internal assessments are conducted regularly, however, no external assessment was undertaken during the period 2009/10 – 2017/18, but a positive step was taken in this regard as it was established that one was undertaken towards the end of 2019.

Concerns raised by the outgoing ACC includes the legislative mandate for IAF to focus on compliance audits rather than value-adding assignments; the negative impact the IAF capacity had on the perceived contributions the IAF made to the municipality; and concerns about the quality of reports, the recommendations by the IAF, and the timeous issuing of reports. These had a negative impact on the perceived value-adding performance of the IAF by the AC. However, the current ACC indicates progress on both quality and timeous issuing

of reports and also indicated that an action plans to further improve the quality of the work performed by the IAF as a result of the external evaluation results have been compiled.

Although combined assurance is not yet embedded at SBM, the outgoing ACC commended the cooperation between IAF and External Audit and saw this move as a beneficial step towards combined assurance (Saldanha Bay Municipality, 2018d). Therefore, positive steps are being taken toward ensuring that the SBM has a fully functional combined assurance framework in place. These positive steps include the identification of service providers that will be included in the combined assurance model and a commitment to have every constituent's role clarified in the next two years.

5.2.3 Output

Although IAF recommendations are implemented, the follow up audits indicate that the implementation rate is rather slow. A slight improvement has been noted, but progress is not satisfactory, which eventually leads to repeat findings by the IAF and AGSA on internal control deficiencies. However, action plans to improve controls and prevent recurring findings, as well as proper record keeping have been identified and monitored for implementation.

Once again, staff shortages impacted on the IAF being externally evaluated. This replicated into external auditors refusing to place reliance on the work done by the IAF for the financial years 2009/10 – 2017/18 due to the absence of an external quality review. However, regular contact between the two parties is a positive move towards implementing combined assurance, and the conclusion of a first ever external quality evaluation should pave way for this sort-after external audit reliance on the work of the IAF.

5.3 CONTRIBUTIONS TO RESEARCH

The study contributed to research by expanding the already established knowledge base on the IAF as a value-adding component of corporate governance. SBM as a whole and its IAF can take this study as a reflection exercise on their part and utilise it as a benchmark towards improving themselves. Although this was a study based on one municipality, the research can be extended to other municipalities.

5.4 RECOMMENDATIONS

For future purposes, the study recommends the AC be directly involved in the appointment of the CAE to contribute towards decision-making that will ultimately enhance CAE independence or the perceived independence and strengthen the IAF. The study recommends that the IAF be involved in strategic issues of the SBM, e.g. the CAE should have a standing invite to the SBM Executive Committee meetings to allow the IAF to add value at a strategic level and become a strategic partner rather than only a party providing support. This effort will permit the IAF to attend to strategic, operational, financial and sustainability matters in its quest of adding value to the SBM. However, this can only be possible with an adequately resourced IAF.

In terms of the skills and competencies lost due to resignations, although it is easier to employ interns and groom them into position, this will not solve the immediate problem of skills and competency requirements at the required levels. Other initiatives, such as outsourcing/co-sourcing of the required skills, should be explored.

Some components of the quality assurance and improvement program are taking place, such as internal assessments, however, efforts should be made to prioritise the documenting and implementation of the quality assurance and improvement strategy, policy, and plan. The effort taken to complete the first ever external assessment in this regard is applauded. Efforts towards combined assurance are acknowledged, however, these efforts need to be integrated for combined assurance to be embedded within the SBM. This should at least start with the drafting of a combined assurance strategy and policy.

The same sentiments are shared regarding the risk management process within SBM. The risk management strategy and policy are in place, though some directorates still do not have reliable risk registers. The committee is in existence, however, to complement their efforts, the risk management office need to be capacitated to drive risk management efforts within the SBM, which will enhance the IAF efforts towards combined assurance.

5.5 SUGGESTIONS FOR FURTHER RESEARCH

Studying the three dimensions for examining the effectiveness of the IAF has kindled the interest to study resourcing for an effective IAF, specifically within the rural local government sphere in the South African context. Dimensions for this study could include but are not

limited to the effect of the size of the municipality on resourcing an IAF that speaks to the IAF budgets and exploring staff retention and/or staff turnover. Further research on combined assurance and the role the IAF can play in the South African rural local government could also prove to be valuable for taking the strategic IAF further.

5.6 CONCLUSION

IAF effectiveness is a valuable, contributing factor to corporate governance. Therefore, IAF capacitation plays an important role in the internal auditing processes as well as internal auditing output. The IAF at SBM has the support of both the AC and the MM, which is a positive contribution towards the effective IAF within sound a corporate governance structure. This position can also help to drive the implementation rate of IAF recommendations to strengthen the internal control environment, thereby improving governance at the SBM.

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- (2010a). Annual Report for the 2009/10 Financial Year. Vredenburg: Saldanha Bay Municipality.
- (2010b). Report of the Auditor-General to the Western Cape Legislature and the Council of Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.
- (2010c). Report from the AC for the year ended 30 June 2010. Vredenburg: Saldanha Bay Municipality.
- (2011a). Annual Report for the 2010/11 Financial Year. Vredenburg: Saldanha Bay Municipality.
- (2011b). Internal Audit Charter. Vredenburg: Saldanha Bay Municipality.
- (2011c). Report of the Auditor-General to the Western Cape Provincial Parliament and the Council on Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.
- (2011d). Report of the AC to the Executive Mayoral Committee and Council of the Saldanha Bay Municipality. Vredenburg: Saldanha Bay Municipality.
- (2012a). Annual Report for the 2011/12 Financial Year. Vredenburg: Saldanha Bay Municipality.
- (2012b). Internal Audit Charter. Vredenburg: Saldanha Bay Municipality.
- (2012c). Minutes of an Audit Committee Meeting of the Saldanha Bay Municipality that was held on Wednesday, 25 July 2012 at 14:00 in the Council Chambers, Vredenburg.
- (2012d). Report of the Auditor-General to the Western Cape Provincial Parliament and the Council on Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.
- (2013a). Annual Report for the 2012/13 Financial Year. Vredenburg: Saldanha Bay Municipality.

- (2013b). Report of the Auditor-General to the Western Cape Provincial Parliament and the Council on Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.
- (2014a). Annual Report for the 2013/14 Financial Year. Vredenburg: Saldanha Bay Municipality.
- (2014b). Internal Audit Charter. Vredenburg: Saldanha Bay Municipality.
- (2014c). Minutes of an AC Meeting of the Saldanha Bay Municipality that was held on Tuesday, 24 June 2014 at 14:00 in the Training/Board Room of Human Resources, Vredenburg.
- (2014d). Report to the AC – Risk Based Audit Plan 2014/15. Vredenburg: Saldanha Bay Municipality.
- (2014e). Report of the Auditor-General to the Western Cape Provincial Parliament and the Council of Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.
- (2014f). Report of the AC to the Executive Mayoral Committee and Council of the Saldanha Bay Municipality. Vredenburg: Saldanha Bay Municipality.
- (2015a). Annual Report for the 2014/15 Financial Year. Vredenburg: Saldanha Bay Municipality.
- (2015b). Minutes of an AC Meeting of the Saldanha Bay Municipality that was held on Tuesday, 10 March 2015 at 14:00 in the Council Chamber, Vredenburg.
- (2015c). Report to the AC – The 2014/15 Risk Based Internal Audit Plan. Vredenburg: Saldanha Bay Municipality.
- (2015d). Report of the Auditor-General to the Western Cape Provincial Parliament and the Council on Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.
- (2016a). Annual Report for the 2015/16 Financial Year. Vredenburg: Saldanha Bay Municipality.

- (2016b). Audit Committee Report to the Executive Mayoral Committee and Council of the Saldanha Bay Municipality. Vredenburg: Saldanha Bay Municipality.
- (2016c). Minutes of an AC Meeting of the Saldanha Bay Municipality that was held on Monday, 27 June 2016 at 14:00 in the Council Chamber, Vredenburg.
- (2016d). Report to the AC – Approval of the 2016/17 Risk Based Internal Audit Plan. Vredenburg: Saldanha Bay Municipality.
- (2016e). Report to the AC – Report on the status of implementation of the approved 2016/17 Risk Based Internal Audit Plan. Vredenburg: Saldanha Bay Municipality.
- (2016f). Report of the Auditor-General to the Western Cape Provincial Parliament and the Council on Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.
- (2017a). Annual Report for the 2016/17 Financial Year. Vredenburg: Saldanha Bay Municipality.
- (2017b). Minutes of an AC Meeting of the Saldanha Bay Municipality that was held on Friday, 30 June 2017 at 10:00 in the Council Chamber, Vredenburg.
- (2017c). Report to the AC – Risk Based Internal Audit Plan for 2017/18. Vredenburg: Saldanha Bay Municipality.
- (2017d). Report of the Auditor-General to the Western Cape Provincial Parliament and the Council on Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.
- (2017e). Report of the AC to the Executive Mayoral Committee and Council of the Saldanha Bay Municipality. Vredenburg: Saldanha Bay Municipality.
- (2018a). Annual Report for the 2017/18 Financial Year. Vredenburg: Saldanha Bay Municipality.
- (2018b). Minutes of an AC Meeting of the Saldanha Bay Municipality that was held on Wednesday, 20 June 2018 at 10:00 in the Council Chamber, Vredenburg.


(2018c). Report of the Auditor-General to the Western Cape Provincial Parliament and the Council on Saldanha Bay Municipality. Cape Town: Saldanha Bay Municipality.

(2018d). Report of the AC to the Executive Mayoral Committee and Council of the Saldanha Bay Municipality. Vredenburg: Saldanha Bay Municipality.

(2019). Internal Audit Charter. Vredenburg: Saldanha Bay Municipality.

ANNEXURES

Annexure A: Permission to conduct research



MUNISIPALITEIT SALDANHA BAY
MUNICIPALITY SALDANHA BAY

MAELD KSB ONS VERW NR:
PLEASE QUOTE OUR REF NO:
NGESICELO BONTSA INOMBOLO:

31/05/12
Shelil

Municipal Manager
Saldanha Bay Municipality
Attention: Internal Audit
MREDEENBURG
7380

021 701 7070 Fax: 022 715 1510
m.m.saldanhabay.co.za
www.saldanhabay.co.za

Manager:
English: D Joubert
Afrikaans: 022 701 7070

23 July 2012

Military Academy
Private Bag X2
Saldanha
7395

Dear Capt O.L. Dichabe

Re:REQUEST FOR APPROVAL TO USE THE INTERNAL AUDIT OF SALDANHA BAY AS A CASE STUDY AS PART OF THE MASTERS STUDY FOR A STUDENT REGISTERED AT THE FACULTY OF MILITARY SCIENCE; UNIVERSITY OF STELLENBOSCH

Your letter dated 9 May 2012 with reference MA/R/81010530CA has reference.

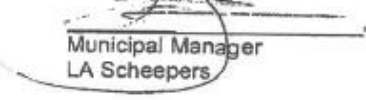
In terms of our new organisational vision to "Serve, Grow and Succeed Together" we welcome your submission to use the Internal Audit Activity of Saldanha Bay Municipality as part of your case study.

Permission is herewith granted to use the Internal Audit Activity of the Saldanha Bay Municipality as part of your case study towards your Master's Degree.

You are kindly requested to adhere to the following:

- Liaise with David Joubert (Manager: Internal Audit) with regard to Internal Audit Activity matters;
- Liaise with David Joubert (Manager: Internal Audit) well in advance to setup contact time (first meeting) with relevant Officials/Management and/or Councilors;
- Relevant documentation will be made available as requested, but the costs for such copies will be for your own account; and
- Documentation/Information/Data classified as confidential should be treated as such and must be cleared with the Municipal Manager prior to publication.

We await the outcome of the results and that it will be beneficial to us in identifying internal audit practises which can be shared and/or improved on.



Municipal Manager
LA Scheepers

Annexure B: Consent to participate in research



UNIVERSITEIT•STELLENBOSCH•UNIVERSITY
jou kennisvennoot • your knowledge partner

STELLENBOSCH UNIVERSITY

CONSENT TO PARTICIPATE IN RESEARCH

You are asked to participate in a research study conducted by Omphemetse Lorraine Dichabe, from the Faculty of Military Science at Stellenbosch University. The results of this research will contribute to compilation of the thesis. You were selected as a possible participant in this study because of the role you occupy at the municipality.

1. PURPOSE OF THE STUDY

The study aims to establish whether the Internal Audit Activity at the municipality has been an effective Corporate Governance tool by way of helping to improve the quality of services rendered to the stakeholders of Saldanha Bay Municipality.

2. PROCEDURES

If you volunteer to participate in this study, we would ask you to do the following:

Answer the questions directed to you in accordance with the work you do for the municipality. These questions will be in relation to what has already been found in the documentation that will be received from the municipality. Yours will be to confirm or elaborate on what has already been documented. The interviews will take place at the municipal offices. You are requested to spare at most an hour of your time for the interview session.

3. POSSIBLE RISKS AND DISCOMFORTS

There are no risks anticipated with the research. You will only be inconvenienced with regards to your time, but the interview will be scheduled at a time appropriate to you.

4. POSSIBLE BENEFITS TO SUBJECTS AND/OR TO THE SOCIETY

The benefit you will get from this research as a participant will be the fulfilment you get for rendering services to the community. The outcome of this research will be used to make recommendations for use within local government structures.

5. PAYMENT FOR PARTICIPATION

Participants will not receive any form of payment for participating in this research.

6. CONFIDENTIALITY

Any information that is obtained in connection with this study and that can be identified with you will remain confidential and will be disclosed only with your permission or as required by law. Confidentiality will be maintained by not mentioning anybody's name in the research results and locking away all documentation (hard copies) and restricting access by password (soft copies). Only the researcher will have access to the key of the cabinet and the password.

7. PARTICIPATION AND WITHDRAWAL

You can choose whether to be in this study or not. If you agree to take part in this study, you may withdraw at any time without any consequence of any kind. You may also refuse to answer any questions you don't want to answer and still remain in the study. The investigator may withdraw you from this study if circumstances arise which warrant doing so

8. IDENTIFICATION OF INVESTIGATORS

If you have any questions or concerns about this research, please feel free to contact Lorraine Dichabe at 0712363801 or Ms Mariaan Roos at 0829251578.

9. RIGHTS OF RESEARCH PARTICIPANTS

You may withdraw your consent at any time and discontinue participation without penalty. You are not waiving any legal claims, rights or remedies because of your participation in this research study. If you have questions regarding your rights as a research participant, contact Ms Maléne Fouché [mfouche@sun.ac.za; 021 808 4622] at the Division for Research Development.

DECLARATION OF CONSENT BY THE PARTICIPANT

As the participant I confirm that:

- I have read the above information and it is written in a language that I am comfortable with.
- I have had a chance to ask questions and all my questions have been answered.
- All issues related to privacy, and the confidentiality and use of the information I provide, have been explained.

By signing below, I _____ agree to take part in this research study, as conducted by _____

Signature of Participant

Date

DECLARATION BY THE PRINCIPAL INVESTIGATOR

As the **principal investigator**, I hereby declare that the information contained in this document has been thoroughly explained to the participant. I also declare that the participant has been encouraged (and has been given ample time) to ask any questions. In addition I would like to select the following option:

	The conversation with the participant was conducted in a language in which the participant is fluent.
	The conversation with the participant was conducted with the assistance of a translator (who has signed a non-disclosure agreement), and this "Consent Form" is available to the participant in a language in which the participant is fluent.

Signature of Principal Investigator

Date

Annexure C: Sample of interview themes

Interview themes revolved around these subject areas:

- Organisational independence, reporting lines, relationship with management
- Proficiency and due professional care, resourcing the IAF
- Quality assurance and improvement program, internal/external assessments
- Combined assurance
- Managing the IAF
- Monitoring progress
- IAF plan, charter, scope of work, restrictions

Annexure D: Sample of interview questions to IAF

(Adapted from the The IIA: Measuring Internal Audit Effectiveness & Efficiency)

Organisational independence

To whom does the IAF report? Functionally / Administratively? What does that entail?

How often is this reporting taking place?

Who decides on the scope of the IAF?

How does the process unfold?

Requirements for the appointments of CAE? Is the AC involved? If not, why?

Frequency of meetings with AC? Which are formal and which are informal and why the need to have dual reporting systems?

To what extent is the AC involved in the appointment of the CAE?

Does the AC evaluate the IAF's compliance with standards?

Individual objectivity

How is (should) the attitude of IAF be?

If there is impairment to organisational independence and individual objectivity, how is that dealt with?

Proficiency and due professional care?

Tell me about the staff component of the IAF.

Does the structure provide for necessary levels of supervision? How has this changed over the years?

Are there job descriptions in place?

Are their qualifications in line with the work they do?

If posts are not filled or are unfunded, how does that affect the work program?

Are there any performance evaluations done by the AC, management and AGSA? How often? If not, why?

Does the staff attend necessary training programs? Any training specific to conformance with standards?

What do you do to ensure that engagements are performed with proficiency and due professional care? If there is a lack, what is done to improve?

How does the municipality support you with regards to continued professional development?

In case where members exit the IAF, who conducts the exit interview? What do they reveal?

Quality assurance and improvement program

Do you have a quality assurance and improvement program in place?

How often is it revised? How often do you report on this program? To whom?

Over the years, has there been non-conformance? If yes, has it been disclosed?

Managing the IAF

What policies and procedures are there to guide the IAF?

How often are these revised? By whom? Approval thereof?

How is this communicated?

Does the IAF have an audit plan? Is it risk-based? How is this plan compiled? Is the audit plan linked to resource requirements?

If there are resource limitations, how is this dealt with?

Is there coordination between the IAF and other internal and external assurance providers?

Is combined assurance functional at SBM?

Governance, risk management and control

What governance processes are in place at SBM? How often are these assessed?

How is the IAF relationships with stakeholders in the governance of SBM?

What are management expectations of the IAF? Interactions? Soft / hard issues identified?

What interventions are there in terms of risk management?

What control measures are there? Are they effective?

When did SBM have fully functional risk registers? Prior to that, how was the strategic IAF plan developed? Was the plan risk-based? If not, when did they become risk-based?

Monitoring progress

Does the IAF report audit performance? Where? How often? If not, why?

What system is in place to monitor the disposition of results communicated to management?

Is the system working effectively?

Does the IAF report on the adequacy and effectiveness of internal controls? Where? How often? Is it timely?

Any improvements as a result of such reporting

Annexure E: Sample of interview questions to management

(Adapted from the The IIA: Measuring Internal Audit Effectiveness & Efficiency)

To whom does the IAF report? Functionally / Administratively?

How often is this reporting taking place?

How is the relationship between the IAF and management?

What are management expectations of the IAF? Interactions? Soft / hard issues identified?

Is the IAF fully resourced? Are their existing skills appropriate? How has this changed over time?

Is the IAF structure aligned with the strategy of the municipality?

Do they focus on areas that are most likely to impact stakeholder value? Which areas are those?

Are they agile enough to address emerging business risks?

Does the IAF contribute to the improvement of the municipal operations and is it perceived by the stakeholders to add value?

How often does the IAF communicate with management? Is the communication effective?

What system is in place to monitor the disposition of results communicated to management?
Is the system working effectively?

Does the IAF report on the adequacy and effectiveness of internal controls? Where? How often? Is it timely?

Is the CAE subjected to a robust annual assessment based on key attributes relevant to the municipality?

Was the IAF internally / externally evaluated? How often, and by whom?

Annexure F: Sample of interview questions to the ACC

(Adapted from the The IIA: Measuring Internal Audit Effectiveness & Efficiency)

To whom does the IAF report? Functionally? Administratively? How often is this reporting taking place? How often does the IAF communicate (not just reporting) with the AC? Is the communication effective?

Who decides on the scope of the IAF? Does the IAF have a charter? Is it risk-based? How often is it revised? Has the IAF performed its work in accordance with the charter?

Is the IAF fully resourced? Are their existing skills appropriate? How has this changed over the years? Is it aligned with the strategy of the municipality? Does it focus on areas that are most likely to impact stakeholder value? Which areas are those?

Does the IAF have a quality and assurance improvement programme in place? How is the progress reported? How often?

Is the CAE subjected to robust annual assessment based on key attributes relevant to the municipality?

How the IAF viewed by management at SBM?

What system is in place to monitor the disposition of results communicated to management? Is the system working effectively?

Does the IAF report on the adequacy and effectiveness of internal controls? Where? How often? Is it timely?

Does the IAF contribute to the improvement of the municipality operations and is it perceived by stakeholders to add value?